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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:	**Summary of Views Expressed at the Working Group Meeting 10-11 April 2008 (Agenda Paper 9D)**

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 (this agenda paper)

This agenda paper (Agenda Paper 9D) is the report of the views and recommendations of the Working Group (WG) members based on discussions at the 10-11 April 2008 WG meeting and subsequent reviews of earlier drafts. It has been prepared as input to the Board's redeliberations of the Exposure Draft (ED).

The WG recommendations in this report are repeated, issue by issue, in Agenda Papers 9A, 9B, and 9C.

Summary of Views Expressed at the Working Group Meeting

10-11 April 2008

1. The IASB's Working Group (WG) on the IFRS for Small and Medium-sized Entities (IFRS for SMEs) met in London on 10-11 April 2008. At that meeting the staff:

    a. Presented a summary of the issues raised in the letters of comment on the Board's February 2007 Exposure Draft (ED) of a proposed IFRS for SMEs. These were split between issues other than disclosure, and disclosure issues.

    b. Presented a summary of the problems encountered by the 116 SMEs that participated in field testing the ED.

    c. Prepared a combined 'inventory' of the principal substantive issues resulting from the analyses of the comment letters and field tests. These were split between issues other than disclosure, and disclosure issues.

    d. Sought the views of WG members on those issues and any other views of WG members on the proposed IFRS for SMEs.

2. This document is a report of the views and recommendations of the WG members. It has been prepared as input to the Board's redeliberations of the ED. Where there was a general consensus among WG members, the report so indicates, with WG members' reasons. Where the report states "WG members recommended", this does not necessarily mean unanimous agreement but, rather, a substantial majority. Where the WG was significantly divided, the report indicates the differing views and arguments put forward.

3. This report does not include disclosure issues. The views and recommendations of WG members on disclosure issues will be provided to the Board in a separate report.

4. This report does not include issues raised in the comment letters or field tests regarding the need for additional guidance. The WG had a general discussion of ways in which additional guidance to support requirements in the IFRS for SMEs might be provided. This included discussion of the IFRS for SMEs training programme being developed by the IASC Foundation Education Department. WG members were very supportive of providing more detailed guidance via training materials. WG members also encouraged the staff to consider inclusion of additional explanatory guidance within the IFRS for SMEs or in the illustrative financial statements, as appropriate, where requirements/sections would benefit from this.

Organisation of this report

5. The sequencing of the issues in this report is as follows:

    a. WG members' views on general issues in the comment letters/field tests – not related to a specific section in the ED (starts at paragraph 8).

b. WG members' views on issues raised in the comment letters/field tests that relate to a specific section in the ED (starts at paragraph 21).

An introductory comment by Working Group members

6. The members of the WG acknowledge the substantial simplifications of full IFRSs that are reflected in the ED. They commend the Board and its staff for the effort and progress that has already been made toward developing a high quality financial reporting standard that is appropriate for SMEs because it reduces the burden on SME preparers of financial statements while, at the same time, it meets the needs of users of SME financial statements. As with any committee of roughly 40 members, the views of WG members varied significantly on the details of how the Board can improve the proposals in the ED. But, on the basis of the discussions at the WG's 10-11 April 2008 meeting, a common view of all of the members of the WG is clear: <u>further simplifications are needed</u>. Members of the WG believe there is a similar overall message in the comment letters and field test reports – though, as with the WG, the views of respondents on specific proposals varied widely.

7. In this report, members of the WG make over 100 recommendations for simplification for consideration by the Board. The comment letters and field test reports have suggested others. WG members readily acknowledge that the quality of financial reporting by the millions of SMEs around the world varies widely and, in many cases, needs substantial improvement. A high quality global standard that is expressly tailored for entities that do not have public accountability can bring about those improvements – but only if jurisdictions and SMEs adopt it. Entities will be reluctant to adopt IFRS for SMEs and local regulators will be reluctant to allow or require its use if the cost and burden of preparing financial statements under the IFRS for SMEs are perceived as too high and not counterbalanced by clear benefits. Members of the WG encourage the Board and its staff to use their judgement and expertise in assessing these potential simplifications in this context.

WG members' views on general issues not related to a specific section in the ED

8. **Stand-alone IFRS for SMEs.** WG members recommended that the IFRS for SMEs should be a completely stand-alone document to improve understandability and usability. Therefore, all cross-references to full IFRSs should be eliminated (with the possible exception of keeping the cross-references to IAS 39 and IFRS 7 if the option to use IAS 39/IFRS 7 as an alternative to Section 11 is retained – WG members were divided on whether to retain that option), including elimination of cross-references relating to:

   a. accounting policy options (optional cross-reference to the more complex option – see paragraph 9 below) and

   b omitted topics (mandatory cross-reference if the SME encounters the situation) – see paragraph 10 below).

9. **Accounting policy options.** All WG members wanted at least some of the options in the ED to be retained, though different WG members supported different options. Some WG members supported removing certain options for

SMEs, for example revaluation of property, plant and equipment and intangibles and the fair value option for financial instruments, as these are rarely used by listed companies and are, therefore, likely to be rarely used by SMEs in most jurisdictions. However, overall WG members acknowledged that different jurisdictions attach different degrees of importance to the various options and, therefore, recommended that all options should be retained in the final IFRS for SMEs (with the exception of the direct method for reporting operating cash flows – see discussion of Section 7 at paragraph 30 below). Jurisdictions should have the ability to prohibit one or more options in their jurisdiction if they wish. WG members were divided on whether to allow SMEs the choice to follow IAS 39/IFRS 7 in full rather than Section 11.

10. **Omitted topics.** WG members recommended addressing the omitted topics as shown in the table below. Where the WG members recommended reinstating the omitted topic into the IFRS for SMEs, they also-generally recommended simplifying the requirements. For the WG members' detailed recommendations, see the specific sections below starting in paragraph 21.

Para in IFRS for SMEs ED	IFRS	Cross-Reference: Omitted topics:	Address but simplify from full IFRS	Do not address in IFRS for SMEs
19.15	IAS 17	Omitted guidance - lessor in a finance lease refers to guidance and disclosures under IAS 17	X	
25.4	IFRS 2	Omitted guidance - for equity settled share based payments refer to measurement and disclosures under IFRS 2.	X	
25.7	IFRS 2	Omitted guidance - for share based payment transactions with cash alternatives refer to guidance under IFRS 2.	X	
29.2, 29.3, 30.21	IAS 29	Omitted guidance - entities whose functional currency is hyperinflationary follow IAS 29 in full and related part of IAS 21.	X	
31.1	IFRS 8	Omitted guidance - entities wishing to produce segment information refer to IFRS 8.		X
34.1	IAS 33	Omitted guidance - entities wishing to produce earnings per share refer to IAS 33		X
35.1(a)	IAS 41	Omitted guidance - entities with biological asses whose fair value is readily determinable without due cost or effort apply fair value model and give disclosures under IAS 41.	X	
35.3	(IFRS 4)*	Omitted guidance - entities who are insurers are outside scope of IFRS for SMEs		X
37.1, 37.2	IAS 34	Omitted guidance – entities wishing to prepare interim reports that conform to the IFRS for SMEs must follow IAS 34		X

11. **If any cross-references are retained.** WG members recommended that if the Board decides to retain any cross-references to full IFRS, the IFRS for SMEs should be clear that the cross-reference relates to the full IFRS that was in place at the time the IFRS for SMEs was issued. That is, a change in the full IFRS would not automatically modify what is required of an SME. This would prevent requirements for SMEs changing more frequently than intended and also prevent version control issues.
12. **Anticipating changes to full IFRSs.** WG members felt that the IFRS for SMEs should not try to anticipate evolving changes to full IFRSs based on Board discussions or Exposure Drafts as these should be dealt with in full IFRSs first. However, WG members noted that if a genuine simplification of full IFRSs that is considered appropriate for SMEs happens to coincide with the direction that the IASB appears to be following in one of its projects to amend or replace full IFRSs, this should not prevent this simplification being included in the IFRS for SMEs.
13. **Name for 'SME' standard and for the entities eligible to use it.** WG members supported the Board's description of entities that jurisdictions could permit to use the IFRS for SMEs – namely entities that do not have public accountability. They concurred with the Board that the IASB should not establish a quantified 'size test'. However, WG members' views differed on the title of the ED.
    a. Some WG members thought that the current title of the ED is not accurate because it suggests that the group of entities eligible to use the IFRS for SMEs is based on size whereas it is based on public accountability.
    b. Other WG members, however, liked the reference to size in the title because the term SME is well recognised worldwide and does not pose any translation issues. There was concern that other less well recognised terms could cause confusion for national regulatory authorities, standard-setters and practitioners.
14. **Possible alternative names.** Among those WG members who would change the title, there was no clear consensus within the group as to the best title. However, the following possibilities were mentioned:
    a. IFRS for Non-publicly Accountable Entities
    b. IFRS for Non-public-Interest Entities
    c. IFRS for Private Entities (Some WG members thought there might be translation problems if the word 'private' is used.)
    d. IFRS for Private Companies
    e. IFRS for Smaller Entities (Some WG member thought this might imply a size test while others felt it was an improvement and only suggests size in relative, rather than absolute, terms.)
    f. IFRS for Private-Interest Entities
    g. IFRS for Unlisted Entities (However, this would be more than just a change of title but rather an expansion of the scope because it would not prohibit unlisted deposit-taking financial institutions from using the IFRS for SMEs. Some WG members support such an expansion of scope because 'unlisted' is easily understood and a jurisdiction that wants to prohibit small financial

institutions from using the IFRS for SMEs is able to do so. Also, this title would imply that full IFRSs are designed exclusively for listed companies, which is not the case.)

h. IFRS for Limited-Interest Entities

15. **Small listed entities.** The WG was divided on whether it should be left to each jurisdiction to decide if small listed entities should be permitted to use the IFRS for SMEs. Some noted in particular that there could be improvements in financial reporting in developing countries and emerging markets if this were allowed.

16. **Entities that receive funds in a fiduciary capacity.** WG members agreed that entities whose primary business is holding funds in a fiduciary capacity are publicly accountable and hence should be out of the scope of the IFRS for SMEs. However, WG members also recommended an entity that holds funds in a fiduciary capacity as a sideline to its principal business - for example a utility company or travel agency that takes deposits - should be permitted to use the IFRS for SMEs if it otherwise qualifies. In addition, WG members felt an explanation should be given of what is meant by fiduciary capacity to avoid differing interpretations between jurisdictions.

17. **Restatements.** WG members supported adding an 'undue cost or effort' principle wherever the IFRS for SMEs requires restatement. Currently the ED requires restatements for the following, with an impracticability exemption in all cases other than one:

    - Consistency of presentation (ED paragraph 3.10, with impracticability exemption)
    - Changes in accounting policy (ED paragraph 10.9, with impracticability exemption)
    - Corrections of prior period errors (ED paragraph 10.20, but 10.21 has an exemption for impracticability)
    - Discontinued operations (ED paragraph 36.3, with impracticability exemption)
    - Reclassification of assets as held for sale (ED paragraph 36.4)
    - First-time adoption of the IFRS for SMEs (ED paragraph 38.5, with impracticability exemption in 38.9)

(Impracticable is defined in the ED as follows: 'Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.' The definition does not currently include an undue cost or effort principle.)

18. **Fair value – general.** WG members discussed a number of aspects of the use of 'fair value' in the IFRS for SMEs.

    a. WG members did not agree that an overall 'undue cost or effort' exemption to fair value measurement should be included in the IFRS for SMEs.

    b. WG members felt that the term 'fair value' was unclear to SMEs, even with a definition in the glossary of the IFRS for SMEs. Also they felt it gives SMEs/users of the IFRS for SMEs the perception that the ED would require complex measurements, would require an SME using it to engage outside valuers, and would result in some amounts reported in an SME's financial statements that are not useful or understandable. WG members noted that the guidance in Appendix B to Section 11 applies only to financial instruments and the language used in that guidance is difficult for most SMEs to understand and apply. WG members recommended that in each instance in which the IFRS for SMEs requires a current remeasurement, that requirement should clearly describe in simple language what the basis for measurement is rather than use the generic term ‘fair value’. For example, be clear whether an exit price or an entry price is intended. Describe the measurement rather than just using a label. For example, say ‘the amount that the entity would pay to acquire the asset if it decided to buy it rather than to lease it’. Be clear on whether transaction costs (entry and/or exit) are included.

c. WG members felt that the measurement concepts as described in Section 2 *Concepts and Pervasive Principles* (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 acknowledged that the ED proposes an historical cost model for most non-financial assets (the only exception being those agricultural assets whose fair value can be measured without undue cost or effort), but that does not come across to the reader of the ED. 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 and to make clear that the basic measurement model being proposed for SMEs is a historical cost model.

d. A clear description of the historical cost model should be included in Section 2. 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.

e. Some additional recommendations of WG members regarding fair value measurements for specific assets and liabilities are set out in the relevant sections below.

19. **Interpretations of the IFRS for SMEs.** WG members did not support establishing a process for developing official interpretations of the IFRS for SMEs (including ‘rejection notices’ similar to IFRIC’s). At the WG meeting, the IASC Foundation Education Director presented the Foundation’s plans for comprehensive, multilingual, and free training materials for the IFRS for SMEs, which are expected to be released in mid- to late-2009. WG members felt that this will help a lot in providing the kind of implementation guidance that SMEs need and could be updated on an ongoing basis for emerging issues.

20. **Further simplification.** Although individual WG members had differing views on the most appropriate ways to make further simplifications to the Exposure Draft, WG members expressed a clear need for an overall simplification of the requirements in the Exposure Draft. The summary of WG members comments set out in the sections below provides some ideas for simplification.

WG members' views on issues related to a specific section in the ED

21. **Use by a subsidiary of an IFRS company (Section 1).** Most of the recognition and measurement simplifications proposed in the ED are optional. In most cases, an SME could choose the same recognition and measurement principles as in full IFRSs. However, there are a limited number of mandatory recognition and measurement differences in the ED. The principal ones are:

    - Recognition of actuarial gains and losses in full in profit or loss when they occur (no corridor or deferral).
    - Recognition of pension past service cost in full in profit or loss if it arises (no deferral).
    - Measurement of finance leases at the fair value of the leased property (no present value calculation)
    - Measurement of impairment at the fair value of the impaired asset (no value-in-use calculation).
    - Recognising deferred taxes on (i) initial recognition of assets and liabilities and (ii) undistributed earnings of domestic subsidiaries, branches, associates, and joint ventures.
    - Measuring at fair value all grants relating to assets that will be carried at fair value through profit or loss.

22. WG members considered whether, in these cases, subsidiaries of full IFRS reporters should be allowed an option to use the recognition and measurement principles in full IFRSs but make only the disclosures required by IFRS for SMEs. WG members generally did not have much sympathy for allowing this and 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.

23. **Concepts and pervasive principles (Section 2).** 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.

24. **Financial statement formats and titles (Sections 3-8).** 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. Nor would WG members require SMEs to use standardised titles for financial statements.

25. **Conformity with the revised IAS 1 (2007) (Sections 3-8).** 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 (see paragraphs 28 and 29 below). 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.

26. **Current-non-current balance sheet classification (Section 4).** 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. WG members recommend 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.

27. **Analysis of expenses (Section 5).** 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, interest, employee benefits, and taxes, because disclosure of this information is already required by other sections of the IFRS for SMEs.

28. **Combined statement of income and retained earnings (Section 6).** 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.

29. **Statement of changes in equity (Section 6).** WG members supported retaining the requirement for a statement of changes in equity, rather than providing this information in a note.

30. **Statement of cash flows (Section 7).** WG members supported retaining the requirement for a statement of cash flows. However, they 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. 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.

31. **Consolidation - requirement (Section 9).** WG members would restrict 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:

    - Joint management.
    - Substantial intercompany transactions.
    - Borrowings of one entity secured by assets of the other

- The group being managed as a single economic entity.

WG members would not add a requirement that all minority shareholders must agree before consolidated statements are omitted.

32. **Consolidation – temporary control (Section 9).** 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 the criteria in paragraph 31 are met, a temporarily held subsidiary would not be consolidated.

33. **Combined financial statements (Section 9).** 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.

34. **Separate financial statements (Section 9).**

    a. **Methods of accounting for investments.** WG members generally would not change 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.

    b. **Use of multiple methods.** WG members also supported retaining the requirement that an entity use only one single method as its accounting policy for all such investments.

    c. **Requirement to publish separate financial statements.** WG members also 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.

35. **Accounting policies hierarchy (Section 10).** 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.

36. **Prior period errors (Section 10).** WG members did not support requiring retrospective restatement only for 'fundamental' errors. WG members favoured adding 'material' to ED paragraph 10.20 to be consistent with IAS 8.

37. **Financial instruments – general approach (Section 11).** Before discussing possible changes to Section 11, the WG considered a short presentation by one of the Board members explaining the rationale for the approach that is taken in Section 11. This approach classifies financial instruments according to their cash flow characteristics, thus avoiding the need to define such instruments as derivatives and embedded derivatives, held-to-maturity, and available-for-sale. Also, by making fair value through profit or loss the default classification, Section 11 avoids having to list out all of the specific instruments, or detailed characteristics of instruments, that need to be measured at fair value. Such a list would be lengthy but necessary to avoid the potential for inappropriate accounting.

38. WG members generally understood the rationale of this approach; however they expressed serious concern that the approach appears unnecessarily complex,

particularly for an SME that has only 'plain vanilla' financial instruments such as normal receivables and payables and related bad debts and factoring. WG members felt that the approach of using 'fair value for all financial instruments except' sends completely the wrong message since, for the vast majority of SMEs, the reality will be the cost model. WG members felt strongly that by not defining cost or amortised cost as the default, this approach appears to require an SME to account for significantly more instruments at fair value through profit or loss than even IAS 39. WG members generally recommended:

a. The rationale behind the approach taken in Section 11 should be explained at the outset in as simple terms as possible. It should be clear that the cost model will be appropriate for the significant majority of financial instruments held by SMEs.

b. Section 11 should be reorganised to make it easier to apply by an SME that only has very simple financial instruments. In other words Section 11 could be restructured to distinguish between simple (and common) financial instruments and all others. That could be done, for instance, by adding, up front, examples of the typical kinds of financial instruments that an SME is likely to have, with clear guidance for the accounting required both at acquisition/issuance and subsequently. An SME that has no other financial instruments would then not need to even consider the criteria in paragraph 11.7.

c. Section 11 should be rewritten so that a historical cost model (cost or amortised cost) is the default – that is, 'cost or amortised cost shall be used for all financial instruments except'.

d. The examples of instruments that would be accounted for at cost or amortised cost as listed in 11.10 should be linked to the criteria in 11.7(b), and accounting for them should be described in greater detail.

e. Include a clear description of the cost and amortised cost models.

f. The guidance on fair value in Appendix B to Section 11 is too complex for most SMEs. Rewrite to aim the content at the target audience. Or delete Appendix B entirely because the principles are already set out in paragraphs 11.14 to 11.16.

39. **Effective interest method (Section 11).** WG members did not support providing an accounting policy option for SMEs to use the straight-line method as an alternative to the effective interest method for amortising discounts and premiums. WG members generally acknowledged that the materiality principle in Section 2 would allow SMEs to use the straight line method in some circumstances. WG members generally felt that the effective interest method would be easily understood if illustrated clearly with examples.

40. **Hedge accounting (Section 11).**

a. **SMEs do hedging.** WG members acknowledged that many SMEs enter into hedging transactions and hence would like accounting for hedging to be addressed in IFRS for SMEs.

b. **Hedge accounting optional.** WG members agreed with the ED proposal that hedge accounting should be optional. They also acknowledged that because hedge accounting is optional under Section 11, an SME could avoid the complexities of hedge accounting by simply accounting for the hedging instrument and hedged item as otherwise required in the IFRS for SMEs.

c. **Presentation of hedge accounting.** However, WG member felt that the hedging part of Section 11 is not presented in a way that SMEs can readily understand. Each of the kinds of risks for which hedge accounting is permitted should be illustrated in an easy step-by-step presentation. This would include guidance for measuring hedge effectiveness.

d. **Shortcut method.** There was little support among WG members for providing a short-cut method of the type described in ED paragraph BC75.

e. **Documentation.** WG members felt that the requirements for hedging documentation in ED paragraph 11.30 are appropriate.

f. **Hedging instruments and hedged risks.** The WG considered a short presentation by one of the Board members explaining the rationale for not allowing purchased options and debt instruments as hedging instruments in IFRS for SMEs. The Board member noted that debt instruments are generally not allowed as hedging instruments under IAS 39 and have been excluded from use as hedging instruments under Section 11 mainly as an anti-abuse measure since such hedging instruments allow entities to decided when to turn on and off the switch in terms of recognising gains and losses in income. In the case of purchased options, these were not allowed as hedging instruments in Section 11 as it was considered that unless an entity is fairly sophisticated it is unlikely to use purchased options due to the cost of the premium. The Board member said it was decided to focus only on 'plain vanilla' hedging instruments for simplicity. The main reason for allowing the fallback to full IAS 39 was to allow SMEs who have more sophisticated instruments and want to use sophisticated accounting to do so provided they comply with IAS 39 in full. WG members did not feel strongly that purchased options and debt instruments should be allowed as hedging instruments for SMEs. In addition, they did not show any support for permitting hedge accounting for any additional risks other than those in 11.31.

41. **Impairment of an instrument held at amortised cost (Section 11).** WG members felt the requirement in 11.22(a) for measuring the impairment of an instrument (such as a receivable or loan) that the entity designates at initial recognition to be measured at amortised cost results in departing from cost to a figure that is meaningless. Nonetheless, WG members acknowledged that impairment could not be ignored, and the only alternative is to write the asset down to fair value through profit or loss instead.

42. **Impairment of an instrument carried at cost because fair value is not readily determinable (Section 11).** WG members acknowledged the apparent contradiction of measuring impairment of such an instrument by reference to fair value. Still, most WG member felt that the approach in 11.22(b) is the only possible alternative and in circumstances where it is clear the asset is impaired it would be appropriate to try to approximate the fair value of these assets. Hence most WG members felt the approach should not be changed, although 11.22(b) would benefit from a clearer explanation of the rationale.

43. **Inventories (Section 12)**

   a. **Cost formulas.** WG members did not support allowing SMEs to measure all of their inventory at the most recent prices or most recent costs or by using the LIFO method.

   b. **Non-production overheads.** WG members generally felt that the language used in 12.10 ('it may be appropriate') regarding inclusion of non-production overheads in inventory cost should remain.

44. **Associates and joint ventures (Section 13 and 14).** WG members had mixed views on the appropriate method(s) of accounting for associates and jointly controlled entities and hence the consensus was that the range of methods proposed in the ED should be retained to cater for such views. Because the ED explains the equity method and proportionate consolidated by cross-reference, elimination of all cross-references will require explanation of these two methods in the IFRS for SMEs. WG members favoured adding a description of the cost method to the IFRS for SMEs.

45. **Investment property (Section 15).** As noted in paragraph 9 above, members of the WG supported keeping both accounting policy options as proposed in the ED. Because the ED explains the fair value through profit or loss model by cross-reference, elimination of all cross-references will require explanation of that model in the IFRS for SMEs. In addition, there was no support amongst WG members for a fair value through equity model. WG members supported retaining the option to classify property held under an operating lease as investment property.

46. **Property, plant and equipment (Section 16).**

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

   b. **Annual review of residual value and useful life.** While some WG members found this requirement to be burdensome for an SME, the majority view was not to make any change to the proposal as SMEs would normally be monitoring this type of information as part of good business practice.

   e. **Revaluation of PP&E.** As noted earlier in paragraph 9, WG members would retain this option and other accounting policy options from full IFRSs.

47. **Intangible assets other than goodwill (Section 17).**

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

   b. **Capitalisation of R&D.** WG members supported the proposal to give SMEs the option (not in full IFRSs) to expense all development costs for simplicity.

   c. **Annual review of amortisation method and period.** WG members favoured retaining the requirement as proposed in the ED.

   e. **Revaluation of intangibles.** As noted earlier in paragraph 9, WG members would retain this option and other accounting policy options from full IFRSs.

48. **Goodwill amortisation (Section 18).** WG members unanimously supported requiring amortisation of goodwill over its estimated useful life, subject to an impairment test using the indicator approach proposed in the ED. Many WG members would impose a maximum life of not more than ten years, with some favouring five years. Most WG members acknowledged that the impairment indicator approach proposed in the ED is consistent with the view that there is generally no foreseeable period over which an entity expects to consume the economic benefits embodied in goodwill, and they also acknowledge that the amortisation approach still requires impairment testing. However, many WG members supported amortisation as an appropriate simplification for SMEs as it reduces the likelihood of impairment testing over time. WG members also noted that amortisation can be justified on the basis that purchased goodwill is eventually replaced over time with internally generated goodwill that is not separately recognized. WG members were concerned that impairment testing is a burden for SMEs and therefore want to see the circumstances in which it can be triggered substantially reduced. An annual impairment calculation for goodwill was rejected as too onerous for SMEs.

49. **Business combinations (Section 18)**

    a. **Intangibles.** WG members would continue to require separation of intangibles as proposed in ED paragraph 17.6. It was noted that 'and' in 17.6(b) should be changed to 'or'.

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

    c. **Pooling of interests.** WG members did not support allowing SMEs to follow merger accounting for any business combinations (other than combinations of entities under common control).

50. **Leases (Section 19).**

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

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

    c. **Separation of land and buildings.** WG members felt that the requirements can be left as proposed in the ED.

    d. **Treat all leases as operating leases.** Some WG members felt that this is an appropriate simplification for SMEs. The majority, however, did not feel strongly for or against this proposal.

    e. **Lease classification criteria.** WG members did not support adding quantitative criteria into ED paragraphs 19.4 and 19.5 (for classification of a financing lease).

51. **Provisions (Section 20).** WG members did not recommend any simplifications of Section 20.

52. **Debt - equity classification (Section 21).** Members of the WG recommended adopting in the IFRS for SMEs the recent changes made to IAS 32 regarding classification of puttable instruments and obligations arising on liquidation, though they would simplify the wording. Some WG members were unsure if those changes would be sufficient on their own to address the concerns of cooperatives, and they suggested that some research may be appropriate.

53. **Revenue (Section 22).** WG members did not support using the completed contract method for all long-term contracts. Instead, they recommended:

    a. keeping Section 22 broadly as drafted,

    b. improving the drafting to make it more understandable to SMEs, and

    c. adding additional examples to illustrate percentage-of-completion calculations and presentation.

54. **Government grants (Section 23).** WG members did not discuss Section 23.

55. **Borrowing costs (Section 24).**

    a. **Immediate expensing of all borrowing costs.** WG members supported the proposal to give SMEs the option to expense all borrowing costs since expensing all borrowing costs is the simpler approach.

    b **Use of average borrowing rate for capitalisation.** WG members supported allowing use of the capitalisation model as described in IAS 23. WG members did not support any simplification of this method such as by using the average borrowing rate for all capitalisation.

56. **Share-based payment (Section 25).** Most WG members felt that the intrinsic value method in IFRS 2 is not much of a simplification for SMEs because it still involves determining the fair value of unquoted instruments and additionally requires this to be done every year. Many who hold this view support a disclosure only approach. If the Board does not agree with the disclosure-only approach, WG members recommend that the Board seek further simplifications beyond the requirements of IFRS 2. WG members noted that a few comment letters provided ideas for simplification including:

    - determining intrinsic value at grant date only,
    - using the calculated value method like in the US Standard SFAS 123(R), which also requires measurement only at grant date, and
    - allowing subsidiaries to record a share-based payment expense on the basis of a reasonable allocation of the group charge when awards are granted by a parent company to the employees of different subsidiaries in the group.

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

57. **Impairment (Section 26).**

    a. **Measurement of impairment.** WG members recommended reinstating the notion of 'value in use' in the measurement of impairment since value in use considers the business reality of the future cash flows from the use of assets. Some WG members felt impairment should be measured by comparing carrying amount to the greater of net selling price and value in use. Comment letters suggested two other ways of reintroducing value in use in the IFRS for SMEs. One method would be to allow or require value in use instead of fair value less costs to see. Another method would be to perform an impairment test on the basis of the scenario 'sale or use' that is relevant to the entity. Neither of these two additional options was discussed by the WG.

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

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

58. **Pensions (Section 27).**

a. **Actuarial gains and losses.** WG members would allow all options for actuarial gains and losses that are permitted by IAS 19.

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

c. **Simplified calculations of defined benefit obligations.** Most WG members would encourage the Board to seek simplify the calculation of defined benefit obligations. Some WG members suggested that the calculation could be simplified by measuring the obligation on the basis that all employees would retire at the reporting date. Some WG members would simplify calculations by treating all multiemployer plans as defined contribution.

59. **Income taxes (Section 28).** WG members did not express a clear consensus on how SMEs should account for income taxes; however the majority felt that the current requirements are too complex for SMEs. More WG members leaned toward the taxes payable method than any other method, supported by some note disclosures about tax deferrals. More WG members favoured a timing difference approach than the proposed temporary difference approach as a simplification because comparing the income statement and the tax return is relatively straightforward. There was also support for either not recognising deferred tax assets at all or restricting deferred tax assets to those that are deemed to be realisable in the very short term such as one or two years, because SMEs often do not have accurate cash flow budgets.

60. **Financial reporting in hyperinflationary economies (Section 29).** The Working Group did not discuss Section 29.

61. **Foreign currency translation (Section 30)**.

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

b. **Cumulative exchange differences.** WG members would leave cumulative exchange differences in equity on disposal of a foreign operation, to avoid the administrative burden of tracking historical exchange rates.

62. **Segment reporting (Section 31), earnings per share (Section 34), and interim reporting (Section 37)**. WG members recommended removing these sections entirely, which would enable entities to present voluntary information without having to apply the full IFRS. The hierarchy in Section 10 would then govern, but clear disclosure of the basis of presentation used should be required.

63. **Related parties (Section 33).** This is essentially a disclosure issue so WG members' views will be covered in the separate WG report on disclosures.

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

65. **Assets held for sale and discontinued operations (Section 36).**

    a. **Held for sale.** WG members felt there is no need for a held for sale classification. Instead the impairment requirements in the individual sections of the IFRS for SMEs cover this. The only substantive difference would be continued depreciation of long-lived assets held for sale.

    b. **Discontinued operations.** WG members recommended that prior period financial statements not be restated to segregate discontinued operations.

    c. **Elimination of Section 36.** If both of the foregoing are done, Section 36 can be totally eliminated.

66. **First-time adoption of the IFRS for SMEs (Section 38).**

    a. **Generally satisfactory.** WG members were generally happy with the approach in Section 38.

    b. **Exemptions.** Most WG members would include in Section 38 all of the IFRS 1 optional exemptions for first time adopters (for example, parent and subsidiary adopt at different times, and deemed cost for investment property and intangibles).

    c. **Undue cost or effort exemption.** WG members generally favoured adding an 'undue cost or effort' exemption from the requirement to restate prior periods (a lower hurdle than 'impracticable') as discussed above in paragraph 17.

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