STAFF PAPER

Thursday 25 October 2012

World Standard-setters Meeting

Project	**IFRS for SMEs**		
Paper topic	Comprehensive review of the *IFRS for SMEs*		
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Purpose

The purpose of this agenda paper is to support discussion at the World Standard-setters meeting about eight of the topics in the IASB's Request for Information and focus discussion on those.

Background information

When the IASB issued the *IFRS for SMEs* in July 2009, it said that it would undertake an initial comprehensive review of the Standard to enable the IASB to assess the first two years' experience in implementing the Standard and consider whether there is a need for any amendments. Companies have been using the *IFRS for SMEs* in 2010 and 2011. Therefore, the initial comprehensive review commenced in 2012.

On 26 June 2012 the IASB issued a Request for Information as the first step in that initial comprehensive review the deadline for comment is 30 November 2012. (see http://www.ifrs.org/IFRS-for-SMEs/Documents/RequestforInformation_IFRSforSMEs_WEBSITE.pdf).

Session format

09:45–10:15 Presentation of Comprehensive Review of IFRS for SMEs

Darrel Scott, IASB member

10:15–10:30 Discussion Topic 1 – Use by publicly traded entities

Use by publicly traded entities (Section 1)

The *IFRS for SMEs* currently prohibits an entity whose debt or equity instruments are traded in a public market from using the *IFRS for SMEs* (paragraph 1.3(a)). The IASB concluded that all entities that choose to enter a public securities market become publicly accountable and, therefore, should use full IFRSs.

Some interested parties believe that governments and regulatory authorities in each individual jurisdiction should decide whether some publicly traded entities should be eligible to use the *IFRS for SMEs* on the basis of their assessment of the public interest, the needs of investors in their jurisdiction and the capabilities of those publicly traded companies to implement full IFRSs.

Are the scope requirements of the IFRS *for SMEs* currently too restrictive for publicly traded entities?

a. No—do not change the current requirements. Continue to prohibit an entity whose debt or equity instruments trade in a public market from using the *IFRS for SMEs*.

b. Yes—revise the scope of the *IFRS for SMEs* to permit each jurisdiction to decide whether entities whose debt or equity instruments are traded in a public market should be permitted or required to use the *IFRS for SMEs*.

c. Other—please explain.

Discussion:

3 minutes ‘yes’— Andrew Braithwaite, Caribbean

3 minutes ‘no’— Kimberley Crook

8 minutes—general discussion by WSS participants

1 minute—show of hands: yes, no or other?

10:30–10:45 Discussion Topic 2 – Use by financial institutions

Use by financial institutions (Section 1)

The *IFRS for SMEs* currently prohibits financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses from using the *IFRS for SMEs* (paragraph 1.3(b)). The IASB concluded that standing ready to take and hold funds from a broad group of outsiders makes those entities publicly accountable and, therefore, they should use full IFRSs.

In every jurisdiction financial institutions are subject to regulation. In some jurisdictions, financial institutions such as credit unions and micro banks are very small. Some believe that governments and regulatory authorities in each individual jurisdiction should decide whether some financial institutions should be eligible to use the *IFRS for SMEs* on the basis of their assessment of the public interest, the needs of investors in their jurisdiction and the capabilities of those financial institutions to implement full IFRSs.

Are the scope requirements of the *IFRS for SMEs* currently too restrictive for financial institutions and similar entities?

a. No—do not change the current requirements. Continue to prohibit financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses from using the *IFRS for SMEs*.

b. Yes—revise the scope of the *IFRS for SMEs* to permit each jurisdiction to decide whether financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses should be permitted or required to use the *IFRS for SMEs.*

c. Other—please explain.

Discussion:

3 minutes ‘yes’—Sue Ludolph, South Africa

3 minutes ‘no’—Lirola Keri, Albania

8 minutes—general discussion by WSS participants

1 minute—show of hands: yes, no or other?

10:45–11:00 Discussion Topic 3 – Revaluation of PPE

Revaluation of property, plant and equipment (Section 17)

The *IFRS for SMEs* currently prohibits the revaluation of property, plant and equipment (PPE). Instead, all items of PPE must be measured at cost less any accumulated depreciation and any accumulated impairment losses (cost-depreciation-impairment model—paragraph 17.15). Revaluation of PPE was one of the complex accounting policy options in full IFRSs that the IASB eliminated in the interest of comparability and simplification of the *IFRS for SMEs*.

In full IFRSs, IAS 16 *Property, Plant and Equipment* allows entities to choose a revaluation model, rather than the cost-depreciation-impairment model, for entire classes of PPE. In accordance with the revaluation model in IAS 16, after recognition as an asset, an item of PPE whose fair value can be measured reliably is carried at a revalued amount—its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluation increases are recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus (unless an increase reverses a previous revaluation decrease recognised in profit or loss for the same asset). Revaluation decreases that are in excess of prior increases are recognised in profit or loss. Revaluations must be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

Should an option to use the revaluation model for PPE be added to the *IFRS for SMEs*?

a. No—do not change the current requirements. Continue to require the cost-depreciation-impairment model with no option to revalue items of PPE.

b. Yes—revise the *IFRS for SMEs* to permit an entity to choose, for each major class of PPE, whether to apply the cost-depreciation-impairment model or the revaluation model (the approach in IAS 16).

c. Other—please explain.

Discussion:

3 minutes ‘yes’— Michelle Sansom, UK

3 minutes ‘no’— Nelson Carvalho, Brazil

8 minutes—general discussion by WSS participants

1 minute—show of hands: yes, no or other?

11:00–11:15 Discussion Topic 4 – Capitalisation of development costs

Capitalisation of development costs (Section 18)

The *IFRS for SMEs* currently requires that all research and development costs be charged to expense when incurred unless they form part of the cost of another asset that meets the recognition criteria in the *IFRS for SMEs* (paragraph 18.14). The IASB reached that decision because many preparers and auditors of SME financial statements said that SMEs do not have the resources to assess whether a project is commercially viable on an ongoing basis. Bank lending officers told the IASB that information about capitalised development costs is of little benefit to them, and that they disregard those costs in making lending decisions.

In full IFRSs, IAS 38 *Intangible Assets* requires that all research and some development costs be charged to expense, but development costs incurred after the entity is able to demonstrate that the development has produced an asset with future economic benefits should be capitalised. IAS 38.57 lists certain criteria that must be met for this to be the case*.

Should the *IFRS for SMEs* be changed to require capitalisation of development costs meeting criteria for capitalisation (based on the criteria in IAS 38)?

a. No—do not change the current requirements. Continue to charge all development costs to expense.

b. Yes—revise the *IFRS for SMEs* to require capitalisation of development costs meeting the criteria for capitalisation (the approach in IAS 38).

c. Other—please explain.

*IAS 38.57 states: “An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.

(b) its intention to complete the intangible asset and use or sell it.

(c) its ability to use or sell the intangible asset.

(d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.”

Discussion:

3 minutes 'yes'—Rolf Ulrich, Germany

3 minutes 'no'— Omodele Jones, Sierra Leone

8 minutes—general discussion by WSS participants

1 minute—show of hands

11:15–11:30 Coffee/tea break

11:30–11:45 Discussion Topic 5 – Amortisation period for goodwill and other intangibles

Amortisation period for goodwill and other intangible assets (Section 18)

Paragraph 18.21 requires an entity to amortise an intangible asset on a systematic basis over its useful life. This requirement applies to goodwill as well as other intangible assets (see paragraph 19.23(a)). Paragraph 18.20 states "If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be ten years." Some interested parties have said that, in some cases, although the management of the entity is unable to estimate the useful life reliably, management's judgement is that the useful life is considerably shorter than ten years.

Should paragraph 18.20 be modified to state: "If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be ten years unless a shorter period can be justified"?

a. No—do not change the current requirements. Retain the presumption of ten years if an entity is unable to make a reliable estimate of the useful life of an intangible asset (including goodwill).

b. Yes—modify paragraph 18.20 to establish a presumption of ten years that can be overridden if a shorter period can be justified.

c. Other—please explain.

Discussion:

3 minutes 'yes'—Radoslaw Ignatowski, Poland

3 minutes 'no'—Tom Linsmeier, US

8 minutes—general discussion by WSS participants

1 minute—show of hands: yes, no or other?

11:45–12:00 Discussion Topic 6 – Capitalisation of borrowing costs

Capitalisation of borrowing costs on qualifying assets (Section 25)

The *IFRS for SMEs* currently requires all borrowing costs to be recognised as an expense when incurred (paragraph 25.2). The IASB decided not to require capitalisation of any borrowing costs for cost-benefit reasons, particularly because of the complexity of identifying qualifying assets and calculating the amount of borrowing costs eligible for capitalisation.

IAS 23 *Borrowing Costs* requires that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (ie an asset that necessarily takes a substantial period of time to get ready for use or sale) must be capitalised as part of the cost of that asset, and all other borrowing costs must be recognised as an expense when incurred.

Should Section 25 of the *IFRS for SMEs* be changed so that SMEs are required to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, with all other borrowing costs recognised as an expense when incurred?

a. No—do not change the current requirements. Continue to require all borrowing costs to be recognised as an expense when incurred.

b. Yes—revise the *IFRS for SMEs* to require capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (the approach in IAS 23).

c. Other—please explain.

Discussion:

3 minutes ‘yes’—Sungsoo Kwon, South Korea

3 minutes ‘no’—Jorge Gil, Argentina

8 minutes—general discussion by WSS participants

1 minute—show of hands: yes, no or other?

12:00–12:15 Discussion Topic 7 – Accounting for income taxes

Approach for accounting for deferred income taxes (Section 29)

Section 29 of the *IFRS for SMEs* currently requires that deferred income taxes must be recognised using the temporary difference method. This is also the fundamental approach required by full IFRSs (IAS 12 *Income Taxes*).

Some hold the view that SMEs should recognise deferred income taxes and that the temporary difference method is appropriate. Others hold the view that while SMEs should recognise deferred income taxes, the temporary difference method (which bases deferred taxes on differences between the tax basis of an asset or liability and its carrying amount) is too complex. They propose replacing the temporary difference method with the timing difference method (which bases deferred taxes on differences between when an item of income or expense is recognised for tax purposes and when it is recognised in profit or loss). Others hold the view that SMEs should recognise deferred taxes only for timing differences that are expected to reverse in the near future (sometimes called the 'liability method'). And still others hold the view that SMEs should not recognise any deferred taxes at all (sometimes called the 'taxes payable method').

Should SMEs recognise deferred income taxes and if so, how should they be recognised?

a. Yes—SMEs should recognise deferred income taxes using the temporary difference method (the approach currently used in both the *IFRS for SMEs* and full IFRSs).

b. Yes—SMEs should recognise deferred income taxes using the timing difference method.

c. Yes—SMEs should recognise deferred income taxes using the liability method.

d. No—SMEs should not recognise deferred income taxes at all (ie they should use the taxes payable method), although some related disclosures should be required.

e. Other—please explain.

Discussion:

3 minutes 'yes'— Mohammad Faiz Azmi, Malaysia

3 minutes 'no'— Modest Hamalanni, Zambia

8 minutes—general discussion by WSS participants

1 minute—show of hands: yes, no or other?

12:15–12:30 Discussion Topic 8 – Further need for Q&As

Further need for Q&As

One of the key responsibilities of the SMEIG has been to consider implementation questions raised by users of the *IFRS for SMEs* and to develop proposed non-mandatory guidance in the form of questions and answers (Q&As). These Q&As are intended to help those who use the *IFRS for SMEs* to think about specific accounting questions.

The SMEIG Q&A programme has been limited. Only seven final Q&A have been published. Three of those seven deal with eligibility to use the *IFRS for SMEs*. No additional Q&As are currently under development by the SMEIG.

Some people are of the view that, while the Q&A programme was useful when the *IFRS for SMEs* was first issued so that implementation questions arising in the early years of application around the world could be dealt with, it is no longer needed. Any new issues that arise in the future can be addressed in other ways, for example through education material or future three-yearly updates to the IFRS for SMEs. Many who hold this view think that an ongoing programme of issuing Q&As is inconsistent with the principle-based approach in the *IFRS for SMEs*, is burdensome because Q&As are perceived to add another set of rules on top of the *IFRS for SMEs*, and has the potential to create unnecessary conflict with full IFRSs if issues overlap with issues in full IFRSs.

Others, however, believe that the volume of Q&As issued so far is not excessive and that the non-mandatory guidance is helpful, and not a burden, especially to smaller organisations and in smaller jurisdictions that have limited resources to assist their constituents in implementing the *IFRS for SMEs*. Furthermore, in general, the Q&As released so far provide guidance on considerations when applying judgement, rather than create rules.

Do you believe that the current, limited programme for developing Q&As should continue after this comprehensive review is completed?

a. Yes—the current Q&A programme should be continued.

b. No—the current Q&A programme has served its purpose and should not be continued.

c. Other—please explain.

Discussion:

3 minutes ‘yes’— TBA

3 minutes ‘no’— Gerhard Prachner, Austria

8 minutes—general discussion by WSS participants

1 minute—show of hands: yes, no or other?

12:30–12:45 Other issues and wrap up