

## STAFF PAPER

4-5 February 2013

## SMEIG Meeting

<b>Project</b>	<b>Comprehensive review of the <i>IFRS for SMEs</i></b>		
<b>Paper topic</b>	<b>Issues in the Request for Information (RFI)</b>		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

**Purpose of this paper**

1. This Agenda Paper 2 asks the SME Implementation Group (SMEIG) to discuss the issues in the IASB's June 2012 Request for Information (RFI):  
*Comprehensive Review of the IFRS for SMEs* and to develop a set of recommendations on those issues for the International Accounting Standards Board (IASB) on possible amendments to the *IFRS for SMEs*.
2. This Agenda Paper 2 presents the issues in the RFI, summarises the main comments received from respondents to the RFI on those issues, sets out the questions that IASB staff would like the SMEIG to develop recommendations for, and provides the IASB staff recommendation for each question asked.

**Structure of this paper**

3. This Agenda Paper 2 is set out as follows:
  - (a) Organisation of the issues
  - (b) Summarising responses in the comment letters
  - (c) Scope of the *IFRS for SMEs* (Issue 1-3)
  - (d) New and revised IFRSs (Issue 4)

- (e) Accounting policy options (Issue 5-7)
  - (f) Income tax (Issue 8)
  - (g) Two issues on specific paragraphs in the *IFRS for SMEs*:
    - (i) Amortisation period for goodwill and other intangible assets (Issue 9)
    - (ii) Presentation of share subscriptions receivable (Issue 10)
  - (h) Inclusion of additional topics in the *IFRS for SMEs* (Issue 11)
  - (i) SMEIG Q&As (Issue 12)
4. Agenda Paper 2 covers the issues addressed by individual questions in the RFI. Agenda Paper 3 covers other issues raised by respondents.

### Organisation of the issues

5. Each of the twelve issues in this paper is set out as follows:
- (a) The question(s) in the RFI covered by the issue. For some issues the questions in the RFI have been condensed slightly for this paper.
  - (b) Summary of the main comments received on the issue from the comment letters on the RFI.
  - (c) Staff comments. Additional information that may be useful for the SMEIG discussions, eg relevant paragraphs in the *IFRS for SMEs* or in the Basis for Conclusions accompanying the *IFRS for SMEs*.
  - (d) Staff recommendation. The staff recommendation provides the initial views of the IASB staff members working on the comprehensive review of the *IFRS for SMEs* (this is not the view of the IASB). The SMEIG should not feel restricted by the staff's view when developing their proposals during the meeting.
  - (e) Questions for the SMEIG to discuss. Staff would like the SMEIG to develop recommendations on these questions for the IASB.

## Summarising responses in the comment letters

6. Each question in the RFI provided respondents with several options (eg (a),(b),(c) etc) for answering the question. Respondents were asked to choose the one option for each question that most closely matched their view. In this Agenda Paper 2, staff have provided a summary of the most common comments received for each of the options. The aim of the discussion on this Agenda Paper 2 is for the SMEIG to develop a set of recommendations on how the IASB should deal with the questions in the RFI. Most of the questions do not focus on the detailed wording in the *IFRS for SMEs*. Therefore the staff have not incorporated some of the more detailed comments in the summary as they are not relevant to SMEIG discussions. The staff will consider all comments individually for possible inclusion in agenda papers at future IASB meetings and during drafting of any amendments to the *IFRS for SMEs*.
7. Due to the number of comments received staff is unable to include them all in this Agenda Paper 2. Therefore, staff have provided a summary of points that cover the most common comments raised. However, in some cases, staff also felt it was important to highlight a comment raised by only one or two comment letters because of the nature of the comment.
8. For most questions in the RFI, staff have provided information about the number of comment letters choosing a particular option. However, in developing the staff recommendation staff have focussed more on the comments raised than on the popularity of the options for two reasons:
  - (a) Firstly jurisdictions and types of organisations are not evenly represented by the comment letters received. For example, some countries have issued more than ten comment letters. Other countries are only represented in a combined letter issued by an organisation covering several jurisdictions.
  - (b) Secondly the approach by different respondents to selecting options is inconsistent. Comment letters frequently elect different options, but explain it with a similar narrative. This is because responses often do not closely match any of the options provided in the question. For

analysis purposes, staff have changed the options chosen by some letters to try to adopt a consistency process between letters. However, this has not been possible in all cases due to the wide spectrum of comments received.

## Scope of the *IFRS for SMEs*

### Introduction

9. There are three questions in the RFI that address the scope of the *IFRS for SMEs*:
- (a) Issue 1) Use by publicly traded entities (Question S1 in the RFI)
  - (b) Issue 2) Use by financial institutions (Question S2)
  - (c) Issue 3) Clarification of use by not-for-profit entities (Question S3)

### Issue 1) Use by publicly traded entities (Question S1)

#### Question S1) 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.

Please provide reasoning to support your choice (a), (b) or (c).

**Responses from comment letters**

10. Approximately 70% of comment letters responding to Question S1 would continue to prohibit an entity whose debt or equity instruments trade in a public market (publicly traded entity) from using the *IFRS for SME* (choice (a)). The following points cover the main reasons given:

- (a) Entities that choose to enter a public market are publicly accountable and should apply full IFRSs. Users of the financial statements of publicly traded entities have more comprehensive needs. Full IFRSs have been designed to meet these needs.
- (b) The *IFRS for SMEs* was created for entities that do not have public accountability and users of their financial statements. If the scope is widened to include publicly traded entities, then additional requirements, in particular disclosure requirements, must be added to the *IFRS for SMEs* to satisfy the needs of users of their financial statements. This will make the *IFRS for SMEs* more complex and undermine the original purpose of developing a simplified standard for SMEs.
- (c) It is important that all publicly traded companies have consistent reporting requirements (and therefore apply full IFRSs). Many publicly traded entities have overseas or global stakeholders who compare entities in different jurisdictions. Allowing some publicly traded entities to use the *IFRS for SMEs* may confuse stakeholders. Plus it would be step away from harmonisation of accounting standards in the world's capital markets.
- (d) Jurisdictions can already incorporate *IFRS for SMEs* into local GAAP if they wish to allow certain publicly traded entities to use it. Consequently, there is no need to remove the scope exclusion.
- (e) It would be difficult to extend the scope of the *IFRS for SMEs* to cover some publicly traded entities, but not others because it would be difficult to make an appropriate distinction between different types of publicly traded entities.

11. Approximately 20% of comment letters responding to Question S1 would revise the scope of the *IFRS for SMEs* to permit each jurisdiction to decide whether publicly traded entities should be permitted or required to use the *IFRS for SMEs* (choice (b)). The following points cover the main reasons given:
- (a) The IASB should not decide which standards are applied in different jurisdictions. Local authorities are best placed to judge how the *IFRS for SMEs* is applied in their jurisdiction.
  - (b) Some jurisdictions do not require full IFRSs for publicly traded entities due to its complexity and lack of available local expertise. Instead publicly traded entities use local accounting standards that are inferior to *IFRS for SMEs*. Permitting *IFRS for SMEs* for those entities could be the first step toward full IFRSs and may result in improved reporting. Plus it would lead to greater comparability worldwide through use of an internationally acceptable standard that has close links to full IFRSs.
  - (c) Similarly some publicly traded entities are currently applying full IFRSs, but do not have the expertise to apply it properly. These entities may benefit from being able to use the *IFRS for SMEs*, which may improve their financial reporting.
  - (d) Restricting the scope may cause unnecessary obstacles for adoption of the *IFRS for SMEs* in certain jurisdiction because the scope restriction may conflict with local laws.
12. Some specific concerns were highlighted by comment letters about the current scope:
- (a) Some jurisdictions have junior markets in which the entities are small and public interest is limited. Full IFRSs is onerous for those companies and the *IFRS for SMEs* may be more suitable. Examples of junior markets given in comment letters were the UK Plus market and the Canadian TSX Venture Exchange, including the NEX.
  - (b) Currently the definition of public accountability would include small privately held entities with debt traded in over the counter (OTC)

markets with limited market participants. Such entities may find full IFRSs onerous and should not be considered to be publicly accountable. They should be permitted to use the *IFRS for SMEs*.

- (c) The *IFRS for SMEs* seems to have been simplified from full IFRSs more on the basis of reducing costs than on an assessment of how the needs of users of financial statements of publicly accountable entities differ from those of entities without public accountability.
- (d) The *IFRS for SMEs* was simplified from full IFRSs on the basis of users' needs and cost-benefit analyses. A cost-benefit analysis considers the size and resources of the entity—this is inconsistent with the scope which focuses only on public accountability.

13. Approximately 10% of comment letters responding to Question S1 chose (c) “other”. Other suggestions made by comment letters include:

- (a) Consider removing the scope restriction for publicly-traded entities but provide guidance to assist local authorities in deciding which entities should be permitted or required to use the *IFRS for SMEs*. For example clearly articulate the type of entities for which the *IFRS for SMEs* is intended, explain why it is unsuitable for publicly accountable entities and highlight where it is deficient for their needs and needs of users of their financial statements.
- (b) If an entity with public accountability applies the *IFRS for SMEs*, it would be beneficial for users of its financial statements to be alerted through disclosure that the *IFRS for SMEs* is not intended for that entity.

### **Staff comments**

14. Paragraph P13 of the *IFRS for SMEs* states:

- P13 Decisions on which entities are required or permitted to use the IASB's standards rest with legislative and regulatory authorities and standard-setters in individual jurisdictions. This is true for full IFRSs and for the *IFRS for SMEs*. However, a clear definition of the class of entity for which the *IFRS for SMEs* is intended—as set out in Section 1 of the IFRS—is essential so that (a)

the IASB can decide on the accounting and disclosure requirements that are appropriate for that class of entity and (b) the legislative and regulatory authorities, standard-setters, and reporting entities and their auditors will be informed of the intended scope of applicability of the *IFRS for SMEs*. A clear definition is also essential so that entities that are not small or medium-sized entities, and therefore are not eligible to use the *IFRS for SMEs*, do not assert that they are in compliance with it (see paragraph 1.5).

15. Jurisdictions are not prohibited from permitting or requiring publicly traded entities to use the *IFRS for SMEs*. However, publicly traded entities are prohibited from stating compliance with the *IFRS for SMEs* in their financial statements.

Paragraph 1.5 of the *IFRS for SME* states:

1.5 If a publicly accountable entity uses this IFRS, its financial statements shall not be described as conforming to the *IFRS for SMEs*—even if law or regulation in its jurisdiction permits or requires this IFRS to be used by publicly accountable entities.

16. The *IFRS for SMEs* was simplified from full IFRSs on the basis of users' needs and cost-benefit analyses. A few comment letters stated a cost-benefit analysis is inconsistent with the scope of the *IFRS for SMEs* which focusses only on whether or not an entity has public accountability (not its size or capabilities). However, staff note that in a cost-benefit analysis, the 'benefit' of the information will differ depending on the type of users of the entity's financial statements. Paragraph BC46 of the Basis for Conclusions accompanying the *IFRS for SMEs* highlights this point:

BC46 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 concluded that the cost-benefit trade-off should be assessed in relation to the information needs of the users of an entity's financial statements.

### **Staff recommendation**

17. Staff recommend deleting paragraph 1.5 of the *IFRS for SMEs*. Decisions on which entities are required or permitted to use the IASB's standards rest with the relevant authorities in individual jurisdictions. The staff believe in some cases it may be beneficial for entities with public accountability (as currently defined) to apply the *IFRS for SMEs* for some of the reasons raised by comment letters.



Consequently staff think paragraph 1.5 may be unduly restrictive. The staff believe that the relevant authorities in individual jurisdictions are best placed to decide whether these entities should be permitted to use the *IFRS for SMEs*.

18. The IFRS for SMEs was simplified from full IFRSs on the basis of users' needs and cost-benefit analyses. Therefore, in general, staff do not think the *IFRS for SMEs* is suitable for the needs of users of publicly traded entities. However, the staff also think that in limited cases the needs of the users of certain publicly traded entities may be similar to the needs of users of entities without public accountability. For example, this might be the case for privately held entities with debt traded in over the counter (OTC) markets with limited market participants. Therefore, staff also recommend the IASB consider whether there is any additional guidance that could be added in the *IFRS for SMEs* (or Basis of Conclusions) on the characteristics of entities without public accountability to help jurisdictions assess whether any publicly traded entities have similar characteristics.

#### Question to the SMEIG

**1a) Are the scope requirements of the *IFRS for SMEs* currently too restrictive for publicly traded entities?**

**1b) Should additional guidance be added on the term public accountability?**

## Issue 2) Use by financial institutions (Question S2)

### Question S2) 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 all 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 any 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.

Please provide reasoning to support your choice (a), (b) or (c).

**Responses from comment letters**

19. Approximately 65% of comment letters responding to Question S2 would continue to prohibit all entities that hold assets for a broad group of outsiders as one of their primary businesses from using the *IFRS for SMEs* (choice (a)). The reasons given are similar to those summarised in paragraph 10 for Issue 1.

Additional reasons not covered in paragraph 10 include:

- (a) Regardless of its size, if an entity holds funds for a broad group of outsiders as one of its primary businesses it is publicly accountable and it should apply full IFRSs. There is significant public interest in these entities and they have a responsibility to provide high quality financial statements to address needs of their users.
- (b) Entities that hold assets for a broad group of outsiders are more likely to undertake complex transactions that necessitate full IFRSs. If the scope of the *IFRS for SMEs* is widened to include small financial institutions and similar entities, it is likely that additional requirements, such as disclosure requirements in *IFRS 7 Financial Instruments: Disclosures* will need to be added to satisfy the needs of users of their financial statements. Many small financial institutions have complex financial instruments transactions and the simplified requirements for financial instruments in Section 11 and 12 of the *IFRS for SMEs* may not be sufficient. Adding additional requirements to cater for these entities will

add complexity to the *IFRS for SMEs* and undermine the original purpose of developing a simplified standard for SMEs.

20. Approximately 25% of comment letters responding to Question S2 would revise the scope of the *IFRS for SMEs* to permit each jurisdiction to decide whether 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 SME* (choice (b)). The reasons given are similar to those summarised in paragraph 11 for Issue 1. Additional reasons not covered in paragraph 11 include:
- (a) Costs of compliance with full IFRSs are onerous to some smaller financial institutions, eg very small credit unions and micro banks. These entities often do not have the resources to implement full IFRSs properly. The *IFRS for SMEs* may result in better quality reporting or better suit the needs of these entities and users of their financial statements.
  - (b) In contrast to publicly listed entities, unlisted financial institutions do not have responsibilities related to public capital markets. Satisfaction of local regulatory requirements is sufficient.
  - (c) There is no reason why financial institutions and similar entities should be treated differently from other industries.
  - (d) Financial institutions and similar entities differ in nature and complexity around the world. Some small financial institutions have simple transactions and are similar in nature to small entities without public accountability. Local regulators may consider the *IFRS for SMEs* provides sufficient information for accountability purposes.
21. In addition the following concern was highlighted about the current scope:
- (a) The information needs of stakeholders of publicly traded entities are not necessarily the same as stakeholders of entities holding assets for a broad group of outsiders. For example the most important factor in policyholders' decisions to buy policies from a mutual insurer and remain with these policies or transfer out, is specific policy

performance rather than general entity performance. Similar considerations may apply to friendly societies and credit unions.

- (b) The meaning of fiduciary is unclear as it is a term with different implications across jurisdictions

22. Approximately 10% of comment letters responding to Question S2 chose (c) “other”. Other suggestions made by comment letters are similar to those summarised in paragraph 13 for Issue 1.

### **Staff comments**

23. Paragraph 1.3 of the *IFRS for SMEs* states:
- 1.3 An entity has public accountability if
- (a) .....or
  - (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.
24. Some comment letters wrongly read paragraph 1.3 as saying all banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks are publicly accountable. The staff acknowledge that the wording in Question 2 may be partially to blame—for simplicity and to assist understanding it refers to ‘financial institutions and other entities’ rather than ‘entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses’.
25. Staff would like to emphasise that the entities listed in the second sentence of paragraph 1.3(b) only have public accountability if they hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses. There is a SMEIG Q&A dealing with this issue (Q&A 2011/02 *Entities that typically have public accountability*).

### **Staff recommendation**

26. The staff recommendation for Issue 2 is the same as the staff recommendation for Issue 1. Staff think paragraph 1.5 of the *IFRS for SMEs* may be unduly restrictive.

The staff believe that the relevant authorities in individual jurisdictions are best placed to decide which entities should be permitted to use the *IFRS for SMEs*.

27. If additional guidance is added in the *IFRS for SMEs* (or Basis of Conclusions) on the characteristics of entities without public accountability, this will help eliminate concerns that the term ‘fiduciary capacity’ is not well understood (see staff recommendation for Issue 1).

#### Question to the SMEIG

**2) Are the scope requirements of the *IFRS for SMEs* currently too restrictive for entities that hold assets for a broad group of outsiders as one of their primary businesses?**

### Issue 3) Clarification of use by not-for-profit entities (Question S3)

#### Question S3) Clarification of use by not-for-profit entities (Section 1)

The *IFRS for SMEs* is silent on whether not-for-profit (NFP) entities (eg charities) are eligible to use the *IFRS for SMEs*. Some interested parties have asked whether soliciting and accepting contributions would automatically make an NFP entity publicly accountable.

**Should the *IFRS for SMEs* be revised to clarify whether an NFP entity is eligible to use it?**

- (a) Yes—clarify that soliciting and accepting contributions does not automatically make an NFP entity publicly accountable. An NFP entity can use the *IFRS for SMEs* if it otherwise qualifies under Section 1.
- (b) Yes—clarify that soliciting and accepting contributions will automatically make an NFP entity publicly accountable. As a consequence, an NFP entity cannot use the *IFRS for SMEs*.
- (c) No—do not revise the *IFRS for SMEs* for this issue.
- (d) Other—please explain.

Please provide reasoning to support your choice of (a), (b), (c) or (d).

#### Responses from comment letters

28. Approximately 45% of comment letters responding to Question S3 would clarify that soliciting and accepting contributions does not automatically make an NFP entity publicly accountable (choice (a)). The following points cover the main reasons given:

- (a) We do not believe it is the IASB's intention that NFP entities, eg charities, are publicly accountable.
- (b) NFP entities are often small and full IFRSs is onerous for them. In the absence of an international standard for NFP entities it would be useful to clarify that the *IFRS for SMEs* could be used/adapted in those countries which have no local NFP standard.
- (c) The fact that the *IFRS for SMEs* does not address specific issues for NFP entities does not imply it is inappropriate for them. Individual companies should assess whether it meets their needs. Alternatively, jurisdictions can determine whether the *IFRS for SMEs* is appropriate for NFP entities.
- (d) Clarification would avoid diversity in practice. However, such guidance should be clearly worded to avoid unintended misuse by entities.

29. Approximately 5% of comment letters responding to Question S3 would clarify that soliciting and accepting contributions will automatically make an NFP entity publicly accountable (choice (b)). The following points cover the main reasons given:

- (a) Entities that accept contributions from the public should have a higher level of accountability and apply full IFRSs. They have a responsibility to provide high quality financial statements to address needs of donors, beneficiaries, etc.
- (b) Often donations are sourced from tax payers money (eg due to tax relief) and so there is significant public interest in these entities.

30. Approximately 30% of comment letters responding to Question S3 would not revise the *IFRS for SMEs* for this issue (choice (c)). The following points cover the main reasons given:

- (a) The *IFRS for SMEs* and full IFRSs are aimed at the for-profit sector and do not consider the unique needs of NFP entities and users of their financial statements. If the scope is widened, the *IFRS for SMEs* would need to incorporate addition guidance and disclosure requirements to

address issues specific to NFP entities. This would add complexity to the *IFRS for SMEs*.

- (b) The Trustees of the IFRS Foundation concluded that in the short term the primary focus of IFRS Foundation and IASB should remain on developing standards for for-profit entities. The next Constitution Review commencing in less than three years' time will provide an opportunity to consider any expansion of scope. Until this time the *IFRS for SMEs* should remain silent on NFP entities.
- (c) Whether the *IFRS for SMEs* or full IFRSs can be extended to NFP entities requires analysis and should not be part of this comprehensive review of the *IFRS for SMEs*.
- (d) Application of the *IFRS for SMEs* to NFP entities should be left to local authorities in individual jurisdictions to decide.
- (e) There is no need for further clarification. Paragraph 1.4 of the *IFRS for SMEs* already notes that if charitable organisations hold assets in a fiduciary capacity for a broad group of outsiders for reasons incidental to a primary business it does not make them publicly accountable.

31. Approximately 20% of comment letters responding to Question S3 chose (d) “other”. Other suggestions made by comment letters include:

- (a) The *IFRS for SMEs* should not be revised. Instead, the IASB should clearly state in the Basis for Conclusions accompanying the *IFRS for SMEs* that it is not appropriate for NFP entities. The IASB should further state the reason for this is it doesn't deal with the type of transaction they typically face (rather than because they are publicly accountable).
- (b) The IASB should consider a separate project to address the application of the *IFRS for SMEs* and full IFRSs to NFP entities. The IASB should also consider whether to develop a separate accounting standard for NFP entities. Alternatively there should be a separate section in the *IFRS for SMEs* dealing with NFP issues.

- (c) NFP entities do not meet the definition of public accountability.  
However, these entities may be publicly accountable in the general sense of that term rather than under the definition in the *IFRS for SMEs*.
- (d) Clarify what is meant by NFP entities. For example, credit unions are often considered NFP institutions because they are cooperatives which exist to serve their members rather than to maximize profits. This is distinguishable from concept of a ‘non-profit’ like a charity.
- (e) The meaning of fiduciary capacity should be clarified and tightened in the *IFRS for SMEs* to help address issues like this.

### **Staff comments**

32. Paragraph 1.4 of the *IFRS for SMEs* states:

- 1.4 Some entities may also hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity. However, if they do so for reasons incidental to a primary business (as, for example, may be the case for travel or real estate agents, schools, charitable organisations, co-operative enterprises requiring a nominal membership deposit, and sellers that receive payment in advance of delivery of the goods or services such as utility companies), that does not make them publicly accountable.

### **Staff recommendation**

33. The staff recommend that the *IFRS for SMEs* is not changed. Staff agree that soliciting and accepting contributions does not automatically make an NFP entity publicly accountable. However, paragraph 1.4 of the *IFRS for SMEs* provides sufficient guidance on this matter. Staff does not propose adding further guidance for the following reasons:

- (a) To include guidance would involve defining what is meant by a NFP entity and this may be difficult across different jurisdictions.
- (a) The fact there are no special considerations in the *IFRS for SMEs* for NFP entities does not imply it is inappropriate for them. However, staff feel it is better to stay silent rather than indicate the *IFRS for SMEs* may be appropriate for them. This is not done in full IFRSs.



34. There is nothing in the *IFRS for SMEs* to prohibit NFP entities from using the *IFRS for SMEs*. Therefore, if a NFP entity is not publicly accountable (as defined in Section 1 of the *IFRS for SME*), it may apply and state compliance with the *IFRS for SMEs* provided it is permitted to do so by the laws in its jurisdiction.

#### Question to the SMEIG

3) Should the *IFRS for SMEs* be revised to clarify whether an NFP entity is eligible to use it?

## New and revised IFRSs

### Introduction

35. There are several questions in the RFI about new and revised IFRSs issued since the *IFRS for SMEs* was published in 2009. The staff suggest the SMEIG develop an overall recommendation for the IASB on how to deal with changes to full IFRSs before looking at each of the new or revised IFRSs in turn. The following questions in the RFI relate to new and revised IFRSs:

- (a) Changes from IFRS 10 *Consolidated Financial Statements* (Question S4)
- (b) Changes from IFRS 13 *Fair Value Measurement* (Question S6 and S7)
- (c) Changes from IFRS 11 *Joint Arrangements* (Question S8)
- (d) Changes from IFRS 3 (2008) *Business Combinations* (Question S12)
- (e) IAS 19 (2011) *Employee Benefits* (Question S15)
- (f) Consideration of minor improvements to full IFRSs (Question G1)

(There is also a question about a recent amendment to IAS 12 *Income Taxes* – this will be discussed under Issue 8 on income tax)

#### Issue 4) Consideration of new and revised IFRSs (Various questions in RFI)

36. The RFI asked whether any modifications to the *IFRS for SMEs* are needed as a result of requirements in four new or revised IFRSs issued since the IFRS for SME was published—IFRS 10, IFRS 11, IFRS 13 and IAS 19 (revised 2011). The RFI stated that the changes introduced by those four IFRSs (specifically those listed in questions S4, S6, S8 and S15) are considered to be the main recognition and measurement changes from new and revised IFRSs that relate to (and hence could affect) requirements in the *IFRS for SMEs*. The IASB also asked whether any changes are need as a result of IFRS 3(2008). IFRS 3(2008) was issued shortly before the *IFRS for SMEs* was issued and so it was not incorporated in the *IFRS for SMEs*. The questions in the RFI covering individual IFRS standards only list the significant changes to full IFRSs. Consequently the RFI also asked a separate question on dealing with minor improvements to full IFRSs, eg wording changes. The questions in the RFI are below:

##### **Question S4) Consideration of recent changes to the consolidation guidance in full IFRSs (Section 9)**

IFRS 10 includes additional guidance on applying the control principle in a number of situations, with the intention of avoiding divergence in practice. The guidance will generally affect borderline cases where it is difficult to establish if an entity has control (ie, most straightforward parent-subsidiary relationships will not be affected). Additional guidance is provided in IFRS 10 for:

- agency relationships, where one entity legally appoints another to act on its behalf. This guidance is particularly relevant to investment managers that make decisions on behalf of investors. Fund managers and entities that hold assets for a broad group of outsiders as a primary business are generally outside the scope of the *IFRS for SMEs*.
- control with less than a majority of the voting rights, sometimes called ‘de facto control’ (addressed in paragraph 9.5 of the *IFRS for SMEs* but in less detail than in IFRS 10).
- assessing control where potential voting rights exist, such as options, rights or conversion features that, if exercised, give the holder additional voting rights (addressed in paragraph 9.6 but in less detail than in IFRS 10).

The changes above will generally mean that more judgement needs to be applied in borderline cases and where more complex relationships exist.

**Question S6 and S7) Guidance on fair value measurement for financial and non-financial items and positioning of that guidance (Section 11 and others)**

Paragraphs 11.27–11.32 of the *IFRS for SMEs* are based on IAS 39 and contain guidance on fair value measurement. Those paragraphs are written within the context of financial instruments. However, several other sections of the *IFRS for SMEs* make reference to them.

Recently the guidance on fair value in full IFRSs, including IAS 39, has been consolidated and comprehensively updated by IFRS 13. Some of the main changes are:

- an emphasis that fair value is a market-based measurement (not an entity-specific measurement);
- an amendment to the definition of fair value to focus on an exit price (“the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”); and
- more specific guidance on determining fair value, including assessing the highest and best use of non-financial assets and identifying the principal market.

In straightforward cases, applying the IFRS 13 guidance on fair value would have no impact on the way fair value measurements are made under the *IFRS for SMEs*. However, if the new guidance was to be incorporated into the *IFRS for SMEs*, SMEs would need to re-evaluate their methods for determining fair value amounts to confirm that this is the case (particularly for non-financial assets) and use greater judgement in assessing what data market participants would use when pricing an asset or liability.

**Question S8) Consideration of recent changes to accounting for joint ventures in full IFRSs (Section 15)**

IFRS 11 classifies and account for a joint arrangement on the basis of the parties’ rights and obligations under the arrangement. Previously under IAS 31, the structure of the arrangement was the main determinant of the accounting (ie establishment of a corporation, partnership or other entity was required to account for the arrangement as a jointly-controlled entity). In line with this, IFRS 11 changes the definitions and terminology and classifies arrangements as either joint operations or joint ventures.

Section 15 is based on IAS 31 except it does not permit proportionate consolidation for joint ventures. If the changes under IFRS 11 described above were adopted in Section 15, in most cases, jointly controlled assets and jointly controlled operations would become joint operations, and jointly controlled entities would become joint ventures. Consequently, there would be no change to the way they are accounted for under Section 15.

However, it is possible that, as a result of the changes, an investment that previously met the definition of a jointly controlled entity would become a joint operation.

**Question S12) Consideration of changes to accounting for business combinations in full IFRSs (Section 19)**

Section 19 of the *IFRS for SMEs* is generally based on IFRS 3 (2004). IFRS 3 was revised in 2008, which was near the time of the release of the *IFRS for SMEs*. The main changes introduced by IFRS 3 (2008) that could be considered for incorporation in the *IFRS for SMEs* are:

- Acquisition-related costs are recognised as an expense rather than treated as part of the business combination (for example, advisory, valuation and other professional and administrative fees).
- Contingent consideration is recognised at fair value and then subsequently accounted for

as a financial instrument instead of as an adjustment to the cost of the business combination.

- Determining goodwill requires remeasurement to fair value of any existing interest in the acquired company and measurement of any non-controlling interest in the acquired company.

#### **Question S15) Presentation of actuarial gains or losses (Section 28)**

In accordance with the *IFRS for SMEs*, an entity is required to recognise all actuarial gains and losses in the period in which they occur, either in profit or loss or in other comprehensive income as an accounting policy election (paragraph 28.24).

A key change as a result of the 2011 revisions to IAS 19 is that all actuarial gains and losses must be recognised in other comprehensive income in the period in which they arise.

Section 28 is based on IAS 19 before the 2011 revisions. Removing the option for SMEs to recognise actuarial gains and losses in profit or loss would improve comparability between SMEs without adding any complexity.

#### **Should the changes outlined above be considered, but modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?**

- No—do not change the current requirements. They are appropriate for SMEs, and SMEs have been able to implement the definition and guidance without problems.
- Yes—revise the *IFRS for SMEs* to reflect the main changes from new and revised IFRSs outlined above (modified as appropriate for SMEs).
- Other—please explain.

Please provide reasoning to support your choice of (a), (b) or (c).

#### **Question G1) Consideration of minor improvements to full IFRSs**

The *IFRS for SMEs* was developed from full IFRSs but tailored for SMEs. As a result, the *IFRS for SMEs* uses identical wording to full IFRSs in many places.

The IASB makes ongoing changes to full IFRSs as part of its Annual Improvements project as well as during other projects. Such amendments may clarify guidance and wording, modify definitions or make other relatively minor amendments to full IFRSs to address unintended consequences, conflicts or oversights.

Some believe that because those changes are intended to improve requirements, they should naturally be incorporated in the *IFRS for SMEs* where they are relevant. Others note that each small change to the *IFRS for SMEs* would unnecessarily increase the reporting burden for SMEs because SMEs would have to assess whether each individual change will affect its current accounting policies. Those who hold that view concluded that, although the *IFRS for SMEs* was based on full IFRSs, it is now a separate Standard and does not need to reflect relatively minor changes in full IFRSs

#### **How should the IASB deal with such minor improvements, where the *IFRS for SMEs* is based on old wording from full IFRSs?**

- Where changes are intended to improve requirements in full IFRSs and there are similar wordings and requirements in the *IFRS for SMEs*, they should be incorporated in the (three-yearly) omnibus exposure draft of changes to the *IFRS for SMEs*.
- Changes should only be made where there is a known problem for SMEs, ie there

should be a rebuttable presumption that changes should not be incorporated in the *IFRS for SMEs*.

(c) The IASB should develop criteria for assessing how any such improvements should be incorporated (please give your suggestions for the criteria to be used).

(d) Other—please explain.

Please provide reasoning to support your choice of (a), (b), (c) or (d).

### **Responses from comment letters**

37. Views on whether or not the *IFRS for SMEs* should be updated during this comprehensive review for new and revised IFRSs issued since the *IFRS for SMEs* was published are evenly split, with a slight majority in favour of updating. There were more respondents in favour of adopting the changes to IAS 19(2011) than the other new and revised IFRSs as it was felt it would result in comparability with full IFRSs without increasing complexity. Furthermore, many comment letters in favour of not updating during this review would favour updating the *IFRS for SMEs* for new and revised IFRSs in the future (at the next triennial review), once the changes become established under full IFRSs.
38. The following points cover the main reasons given by respondents for not revising the *IFRS for SMEs* for new and revised IFRSs during this comprehensive review:
- (a) An automatic requirement to align the *IFRS for SMEs* with full IFRSs would undermine the original purpose of developing a standalone, simplified, set of accounting principles for SMEs.
  - (b) SMEs need a stable platform. Frequent changes in requirements, even minor improvements and wording changes, would be burdensome for SMEs and users of their financial statements. The *IFRS for SMEs* should only be changed where there is a demonstrated need for improving SME reporting justified through an assessment of user needs and cost-benefit considerations.
  - (c) The IASB should not incorporate requirements into the *IFRS for SMEs* before they are effective under full IFRSs and the post-implementation reviews have been concluded. The implementation experience of entities applying full IFRSs will provide an insight on the suitability of

the new requirements for SMEs eg whether they result in an improvement in financial reporting, any unintended consequences or implementation costs, etc. Such experience is particularly important in areas when changes are complex, for example IFRS 10 and 13.

- (d) Changes to full IFRSs should only be implemented in the *IFRS for SMEs* after they have become established under full IFRSs and are unlikely to be amended further. For example the presentation of actuarial gains and losses under full IFRSs is likely to be revisited and so the current accounting policy option to recognise in profit or loss should be retained for now.

39. The following points cover the main reasons given by respondents for revising the *IFRS for SMEs* for new and revised IFRSs during the comprehensive review (modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations):

- (a) Changes are made to full IFRSs for good reasons, eg to improve the quality of financial reporting, clarify requirements or provide more guidance. Therefore it would be inappropriate for the *IFRS for SMEs* to become out of date with current requirements in full IFRSs and continue to be based on inferior versions of full IFRSs that have been replaced. The *IFRS for SMEs* was developed from full IFRSs and so it is logical that it should generally remain in line with full IFRSs where possible.
- (b) Consistent accounting across companies under the *IFRS for SMEs* and full IFRSs is desirable. Although modifications to the *IFRS for SMEs* may be necessary for the needs of SMEs, they should be kept to a minimum. Where modifications are made, there should be an option for an entity to follow the recognition and measurement requirements of full IFRSs.
- (c) Consistency with full IFRSs facilitates entities transitioning from the *IFRS for SMEs* to full IFRSs. Also, consistency between the recognition, measurement and presentation principles of full IFRSs and

the *IFRS for SMEs* is important for subsidiaries that produce full IFRSs information for consolidation purposes.

- (d) Many jurisdictions have adopted both full IFRSs and the *IFRS for SMEs*. It would be confusing for two unrelated sets of standards to be applied in the same jurisdiction. Differences between the *IFRS for SMEs* and full IFRSs could cause confusion for users of financial statements and requires additional education and training of accountants and other parties using both sets of standards.
- (e) Having different definitions and terminology in use under full IFRSs and the *IFRS for SMEs* would be confusing. The definitions of control (IFRS 10) and fair value (IFRS 13) are fundamental to the IFRS Framework and so it is important that the revised definitions are incorporated in the *IFRS for SMEs*. Identical transactions should not be accounted for differently under the two sets of standards.

40. Other suggestions made by comment letters include

- (a) The IASB should develop review criteria to be applied when assessing if and how changes to full IFRSs, including minor improvements, should be incorporated into the *IFRS for SMEs*. This would ensure a consistent approach is followed for updates of the *IFRS for SMEs*, would clarify the objective of the *IFRS for SMEs* and its relationship with full IFRSs, and also enable SMEs to plan for changes for effectively.
- (b) Changes to full IFRSs should not be incorporated if they are unlikely to have a significant effect on the financial reporting of most SMEs, for example IFRS 10 and IFRS 13. To do so would result in an unnecessary burden as SMEs would still need to read and understand the requirements. However, changes to full IFRSs should be incorporated if they relate to SME transactions, eg IFRS 11, IFRS 3(2008) and IAS 19(2011).
- (c) If some, but not all, of the changes from an IFRS standard are incorporated in the *IFRS for SMEs*, care is required to avoid ending up

with a mixed approach, ie a mixture of ‘old and new’ IFRSs, as this may result in an incoherent model. For example, IFRS 3(2008) made significant changes to business combination accounting and the model in IFRS 3(2008) should be incorporated in full or not at all.

- (d) Future updates of the *IFRS for SMEs* would be simplified if the IASB considered potential implications for the *IFRS for SMEs* at the same time as changes are made to full IFRSs. Any proposed changes to the *IFRS for SMEs* would be accumulated and included in the omnibus exposure draft issued as part of the IASB’s review of the *IFRS for SMEs* expected to take place approximately once every three years.

### *Question S7*

41. Approximately 75% of comment letters responding to Question S7 on the placement of the fair value measurement guidance in the *IFRS for SMEs* said it should be moved to a separate section, rather than being left in Section 11. The main reasons given were to make it clear it applies to other sections apart from Section 11 and to maintain consistency with full IFRSs. Approximately 20% of comment letters responding to Question S7 said it should stay in Section 11 because it primarily relates to financial instruments and also because the *IFRS for SMEs* is clear that it applies to other sections. Some comment letters said it should only be moved if fair value measurement guidance is expanded to incorporate the main changes under IFRS 13. Another suggestion was to include fair value measurement guidance in Section 2 *Concepts and Pervasive Principles*.

### **Staff comments**

42. Based on responses to the RFI and also the SME discussion at the World Standard-setters Meeting in October 2012 there seems to be several different opinions and also some confusion about the main objective of the *IFRS for SMEs*.
43. Comment letters have highlighted different possible purposes and uses of the *IFRS for SMEs*:



- (a) A standalone standard tailored for the capabilities of smaller businesses and for needs of users of their financial statements.
  - (b) A standard intended for jurisdictions that do not have a standard for SMEs, for example where full IFRSs is required for all entities.
  - (c) A framework upon which local jurisdictions can develop their own local GAAP for SMEs.
  - (d) An intermediate standard for a company that expects to transition to full IFRSs in the future.
  - (e) A standard useful for non-publicly accountable subsidiaries, joint ventures or associates of an entity with public accountability. In particular the *IFRS for SMEs* reduces the burden of the disclosure requirements for these entities.
  - (f) A standard useful for larger entities without public accountability which wish to have comparability with listed companies applying full IFRSs but also wish to benefit from the reduced disclosure of the *IFRS for SMEs*.
44. Responses to individual questions in the RFI are generally influenced by the respondent's understanding of the purpose of the *IFRS for SMEs* and which entities it should cater for. For example, if a respondent believes the *IFRS for SMEs* should mainly cater for subsidiaries of full IFRS investors, then respondents would prefer the recognition, measurement and presentation requirements of the *IFRS for SMEs* to be fully aligned with full IFRSs, ideally without any time lag.
45. Based on responses in the comment letters the staff have identified the following ways of dealing with changes in full IFRSs:
- (a) The *IFRS for SMEs* is a standalone standard. Changes to full IFRSs should not automatically be incorporated. Plus, changes unrelated to requirements in full IFRSs may be considered (eg including guidance on preparing combined financial statements). All changes to the IFRS for SMEs should be considered for incorporation individually based on

an assessment of the needs of users of SME financial statements, capabilities of SMEs and cost-benefit considerations.

- (b) Same as (a). Furthermore, in general, changes to full IFRSs should only be considered after they have become established under full IFRSs and implementation experience has been assessed (eg after post-implementation reviews have been performed, where applicable). Under this approach there would be more of a time lag between when changes are adopted under full IFRSs and when they are adopted under the *IFRS for SMEs* (likely to be delayed by at least an extra three years—one triennial review later).
- (c) The *IFRS for SMEs* is a simplified version of full IFRSs. It is based on full IFRSs and the main principles in the two sets of standards should be aligned where possible. Changes to full IFRSs should automatically be incorporated in the *IFRS for SMEs*. Such changes may need to be modified for the needs of users of SME financial statements and cost-benefit considerations (eg simplifying requirements where appropriate such as expensing development costs, or removal of accounting policy options if they are too complex for SMEs such as revaluation of intangible assets etc). Changes unrelated to requirements in full IFRSs would only be considered in rare cases.
- (d) Same as (c). However, in general, changes should only be considered after they have become established under full IFRSs and implementation experience has been assessed. Under this approach there would be more of a time lag between when changes are adopted under full IFRSs and when they are adopted under the *IFRS for SMEs*.
- (e) The main aim of the *IFRS for SMEs* is to provide relief from the disclosures in full IFRSs. Recognition, measurement and presentation requirements should be fully aligned with full IFRSs because SMEs should be entitled to follow the same accounting treatment as entities applying full IFRSs if they wish to do so. Therefore the *IFRS for SMEs* would permit the same accounting policy options as full IFRSs but may

offer additional simplified options (eg investments in associates can be accounted for under the equity method or the cost method). Where possible accounting policy options would be contained within the *IFRS for SMEs* (not by cross-reference to full IFRSs). Disclosure requirements should be modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations.

- (f) Regardless of approach, SMEs should be permitted to fallback to full IFRSs for recognition, measurement and presentation requirements (this was suggested for subsidiaries that needed to produce information for consolidation purposes under full IFRSs). This would mean the *IFRS for SMEs* is not a self-contained standard as it would contain cross references to full IFRSs. This method would mean there was no time lag.

### **Staff recommendation**

46. The staff believe the primary aim when developing the *IFRS for SMEs* was to provide a standalone, simplified, set of accounting principles that are appropriate for smaller non-publicly accountable entities. By ‘smaller’ the staff mean it was primarily intended to cater for the needs of small/medium-sized entities that do not have public accountability, in particular those that have less complex transactions, do not have the resources to apply full IFRSs and where comparability with their listed peers is not important. Such entities do not require complex accounting policy options or the detailed guidance in full IFRSs dealing with complex transactions. Therefore staff think the purpose of the *IFRS for SMEs* is mainly to cater for entities in paragraph 43(a) (and perhaps (b)). This aim should not be undermined by trying to cater for the situations in paragraph 43(c)-(f). While the *IFRS for SMEs* may be useful for these purposes, they were not the main reasons for developing the *IFRS for SMEs*.
47. Staff therefore recommend changes to full IFRSs should be considered for incorporation in the *IFRS for SMEs* using the following principles (this is the approach in paragraph 45(b)):

- (a) All changes to full IFRSs should be considered individually and incorporated if appropriate for SMEs based on an assessment of the needs of users of SME financial statements, capabilities of SMEs and cost-benefit considerations.
  - (b) To avoid unnecessarily increasing the reporting burden for SMEs, minor amendments to full IFRSs to address unintended consequences, conflicts or oversights (eg as part of the IASB's Annual Improvement process) should only be made where there is a known problem for SMEs, ie there should be a rebuttable presumption that changes should not be incorporated in the *IFRS for SMEs*.
48. Regarding when changes to full IFRSs, should be considered, staff recommend the following:
- (a) Changes to full IFRSs should only be considered for incorporation in the *IFRS for SMEs* after they have become established under full IFRSs and implementation experience has been assessed (eg after the post-implementation review has been performed, where appropriate). Changes may be considered earlier, for example if they respond to an urgent need—however this is expected to be rare.
  - (b) Any changes proposed to the *IFRS for SMEs* would be issued for public comment as part of the omnibus exposure draft developed during the IASB's triennial review (as set out in P16 to P18 of the *IFRS for SMEs*).
49. Based on the principles recommended by the staff in paragraph 47 and 48, the staff do not recommend any changes for the new and revised IFRSs in Questions S4, S6 (and S7), S8, S12 and S15 are made before they are effective under full IFRSs and the implementation experience has been assessed. The staff will consider minor amendments made to full IFRSs, eg through the IASB's annual improvements process (Question G1) individually and assess if any respond to a known problem for SMEs.

**Question to the SMEIG**

<p><b>4a) Do SMEIG members agree that the main objective of the <i>IFRS for SMEs</i> should be to provide a standalone, simplified, self-contained set of accounting principles that are appropriate for small/medium-sized entities that do not have public accountability? Do SMEIG members think the objective of the <i>IFRS for SMEs</i> needs to be clearer?</b></p> <p><b>4b) As a matter of policy, how should the <i>IFRS for SMEs</i> be updated for new and revised IFRSs and annual improvements?</b></p> <p><b>4c) How should this policy be applied to the following new or revised IFRSs?</b></p>	
<b>4c i) Changes from IFRS 10 <i>Consolidated Financial Statements</i> (Question S4)</b>	
<b>4c ii) Changes from IFRS 13 <i>Fair Value Measurement</i> (Question S6)</b> <b>4c iii) Moving guidance from Section 11 into a separate section (Question S7)</b>	
<b>4c iv) Changes from IFRS 11 <i>Joint Arrangements</i> (Question S8)</b>	
<b>4c v) Changes from IFRS 3 <i>Business Combinations</i> (2008) (Question S12)</b>	
<b>4c vi) Changes from IAS 19 <i>Employee Benefits</i> (2011) (Question S15)</b>	
<b>4c vii) Other changes to full IFRSs not specifically covered in the RFI, eg changes to IAS 1 <i>Presentation of Items of Other Comprehensive Income</i> and IFRS 1 <i>First-time Adoption of IFRSs</i></b>	
<b>4c viii) Minor amendments, eg to clarify guidance and wording, modify definitions or make other relatively minor amendments to full IFRSs to address unintended consequences, conflicts or oversights (Question G1)</b>	

## Accounting policy options

### Introduction

50. There are four questions in the RFI that relate to whether SMEs should be able to apply a more complex accounting policy based on requirements currently required or permitted in full IFRSs. These questions are as follows:

- (g) Issue 5) Revaluation of property, plant and equipment (Question S9)
- (h) Issue 6a) Capitalisation of development costs (Question S10)
- (i) Issue 6b) Capitalisation of borrowing costs on qualifying assets (Question S14)

- (j) Issue 7) Use of recognition and measurement provisions in full IFRSs for financial instruments (Question S5)

## Issue 5) Revaluation of property, plant and equipment (Question S9)

### Question S9) Revaluation of property, plant and equipment (Section 17)

The *IFRS for SMEs* currently prohibits the revaluation of property, plant and equipment (PPE). 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*.

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, 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 impairment losses. Revaluation increases are recognised in other comprehensive income and are 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.

Please provide reasoning to support your choice of (a), (b) or (c).

### Responses from comment letters

51. Approximately 30% of comment letters responding to Question S9 would not add an accounting policy option to revalue PPE to the *IFRS for SME* (choice (a)). The following points cover the main reasons given:

- (a) There was a length debate on accounting policy options when the *IFRS for SMEs* was being developed. It is not clear why the IASB are reconsidering their decision in BC84 to BC94 of the Basis for Conclusions. Introducing options makes the *IFRS for SMEs* more

complex and reduces comparability between SMEs. Options increase costs for both preparers, eg when deciding which option to use and additional costs if they choose the more complex option. Options increase costs for users as they need to examine the different policies chosen and assess their effects. The cost model for PPE meets the needs of smaller entities.

- (b) If a revaluation model is added, more complex requirements will need to be added in other areas of the *IFRS for SMEs*, eg for deferred taxation and impairment requirements.
- (c) SMEs do not need to revalue their PPE to improve access to loan financing. Instead, companies can provide revaluation disclosures in the notes to the financial statements or obtain third party valuations of properties. Regardless of the accounting policy chosen, financial institutions often require a separate valuation to be performed before providing loan finance.
- (d) Reliable fair values are often unavailable for items of PPE (this is a bigger issues in developing jurisdictions). Revaluation of PPE in the absence of public information on market values introduces subjectivity and reduce the reliability of financial information.
- (e) The fair value of a non-financial asset is only relevant to users of the financial statements if the SME is likely to sell the item in the near future. Most PPE is used within the business for its useful life and then scrapped.

52. Approximately 65% of comment letters responding to Question S9 would permit an entity to choose, for each major class of PPE, whether to apply the cost model or the revaluation model (choice (b)). The following points cover the main reasons given:

- (a) Adding a revaluation option would not add significant complexity to the *IFRS for SMEs* as SMEs can choose the simpler option, ie the cost model.

- (b) The revaluation model is not complex and is already commonly applied by small entities in many jurisdictions. Not allowing a revaluation option may be a barrier to adoption of the *IFRS for SMEs* in some jurisdictions, eg where revaluation is compulsory or SMEs commonly revalue their PPE.
- (c) Allowing the revaluation model for PPE may improve access to loan financing and enable entities to better comply with debt-equity ratios in loan covenants. If entities are currently applying a revaluation model under local GAAP, a change to a cost model on adoption of the *IFRS for SMEs* may affect borrowing arrangements.
- (d) Measuring property at fair value presents a more accurate reflection of financial position. SMEs should not be prohibited from providing users of financial statements with the most up to date and relevant information.
- (e) It is important that entities with significant PPE operating in high inflationary economies or in countries with restrictions relating to foreign currency exchange can revalue those items. In high inflationary economies historic cost will be much lower than current cost. Plus, whilst income increases by inflation, depreciation does not unless the PPE is revalued.
- (f) Although allowing a revaluation option would reduce comparability between SMEs, the option is currently permitted under full IFRSs. It could be argued comparability between listed companies is more important than SMEs. Also allowing a revaluation option would improve comparability of SMEs with companies applying full IFRSs. Many entities want to revalue PPE to be comparable with entities applying full IFRSs. Plus, banks and lenders want to be able to compare entities across industry segments.
- (g) Allowing full IFRS accounting policy options in the *IFRS for SMEs* would enable subsidiaries that need to prepare information for consolidation purposes under full IFRSs to align their accounting



policies with those of the group. Options also facilitate entities transitioning from the *IFRS for SMEs* to full IFRSs.

53. Approximately 5% of comment letters responding to Question S9 chose (c) “other”. Other suggestions made by comment letters include:
- (a) Companies could provide revaluation disclosures in the notes to the financial statements.
  - (b) More complex options, eg the revaluation model, could be included in an appendix to the *IFRS for SMEs* or included within a separate box within the sections. This would allow SMEs that do not want to use complex options to easily ignore the additional requirements. The IASB could also signal which is the simpler option by having a default option (eg cost model) and a permitted alternative (eg revaluation model) to ensure entities do not have to spend resources finding the less costly alternative.
  - (c) If options are inserted in separate boxed sections (or in an appendix), jurisdictions could easily choose to include or exclude them as appropriate when adopting the *IFRS for SMEs*. This would be better than each jurisdiction adapting the *IFRS for SMEs* themselves by writing their own options (eg as has been done in the UK). The IASB could also publish a core *IFRS for SMEs* (ie excluding all the boxed sections) for jurisdictions where complex options are considered not to be required.

### **Staff comments**

54. Paragraphs BC89-94 in the Basis for Conclusions accompanying the *IFRS for SMEs* contain the IASB’s reasoning for whether accounting policy options in full IFRSs should be allowed in the *IFRS for SMEs*. Paragraph BC84 lists how the IASB dealt with the individual options:

BC84 The accounting policy options mentioned in paragraph BC81(a) for which the exposure draft had included cross-references to full IFRSs have been dealt with in the *IFRS for SMEs* as follows:

- (a) **Associates.** The options proposed in the exposure draft (cost method, equity method and fair value through profit or loss) are all allowed and incorporated into the *IFRS for SMEs*.
  - (b) **Borrowing costs.** The capitalisation model is not an option. Therefore, no cross-reference to full IFRSs. Guidance on applying the expense method had been proposed in the exposure draft and has been retained.
  - (c) **Development costs.** Capitalisation of development costs is not an option. Therefore, no cross-reference to full IFRSs.
  - (d) **Intangible assets.** The revaluation model is not an option. Therefore, no cross-reference to full IFRSs. Guidance on applying the cost-depreciation-impairment model had been proposed in the exposure draft and has been retained.
  - (e) **Investment property.** Measurement is driven by circumstances rather than an accounting policy choice between the cost and fair value models. If an entity can measure the fair value of an item of investment property reliably without undue cost or effort, it must use the fair value model. Otherwise, it must use the cost model. Guidance on applying the fair value model has been incorporated into the *IFRS for SMEs*.
  - (f) **Jointly controlled entities.** The options in the exposure draft are all allowed (with the exception of proportionate consolidation) and incorporated into the *IFRS for SMEs*.
  - (g) **Presenting operating cash flows.** The option to use either the direct or the indirect method has been retained. Guidance on applying direct method has been incorporated into the *IFRS for SMEs*. Guidance on applying the indirect method had been proposed in the exposure draft and has been retained.
  - (h) **Property, plant and equipment.** The revaluation model is not an option. Therefore, no cross-reference to full IFRSs. Guidance on applying the cost-depreciation-impairment model had been proposed in the exposure draft and has been retained.
  - (i) **Government grants.** The proposed option to apply IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* to some government grants has been removed.
- BC89 Full IFRSs include some accounting policy options (choices). Generally, for a given transaction, event or condition, one of the options is simpler to implement than the other(s). Some believe that the *IFRS for SMEs* should eliminate all accounting policy options and, therefore, require all SMEs to follow a single accounting policy for a given transaction, event or condition. Those who hold this view argue that the benefits would be simplification of the *IFRS for SMEs* and greater comparability of the resulting financial information among SMEs using the *IFRS for SMEs*. Others argue that prohibiting SMEs from using an accounting policy option that is available to entities using full IFRSs could hinder comparability between SMEs and entities applying full IFRSs.
- BC90 In developing the exposure draft, the Board considered both points of view and, on balance, had concluded that all options in full IFRSs should be available to SMEs. At the same time, the Board recognised that most SMEs are likely to prefer the simpler option in full IFRSs. Therefore, the exposure draft proposed that when full IFRSs allow accounting policy options, the *IFRS for SMEs* should

include only the simpler option, and the other (more complex) option(s) should be available to SMEs by cross-reference to the full IFRS.

- BC91 Respondents to the exposure draft were divided on whether the more complex options should be available to SMEs. Their comments reflected both of the points of view described in paragraph BC89. Many respondents argued that allowing the complex accounting policy options is not consistent with the Board's objective of a simplified standard for smaller entities and would hinder comparability. For example, while supporting the Board's tentative decision to make the *IFRS for SMEs* a stand-alone standard, the European Financial Reporting Advisory Group (EFRAG) and the European Federation of Accountants (FEE) and some national professional accountancy bodies and standard-setters wrote to the Board disagreeing with the tentative decision during redeliberations to retain all or most of the complex options. This issue was discussed at the Standards Advisory Council (SAC) meeting in November 2008, and all SAC members supported allowing in the *IFRS for SMEs* only the simpler options. They noted that most SMEs will choose to follow the simpler options as they will generally be less costly, require less expertise and achieve greater comparability with their peers. They also pointed out that if a private entity feels strongly about using one or more of the complex options, it could elect to follow full IFRSs rather than the *IFRS for SMEs*.
- BC92 Many who supported not permitting the complex accounting policy options felt that this would benefit users of financial statements who need to make comparisons between smaller entities. Users of SMEs' financial statements are often less sophisticated than users of financial statements of publicly accountable entities and so would benefit from less variation in accounting requirements between entities. Moreover, reducing options does not hinder comparability with entities using full IFRSs since, in many cases under full IFRSs, entities may apply different accounting policies from each other for the same transactions.
- BC93 Virtually all who favoured keeping at least some of the options also favoured making the *IFRS for SMEs* a stand-alone document, which would mean that the options would be addressed directly in the *IFRS for SMEs* rather than by cross-reference to full IFRSs. They acknowledged that this could cause a significant increase in the size of the *IFRS for SMEs*.
- BC94 After considering the alternatives, the Board concluded that some of the options should not be available to SMEs while others should be available to SMEs. Furthermore, to make the *IFRS for SMEs* a stand-alone document, the Board concluded that those options available to SMEs should be addressed directly, appropriately simplified from full IFRSs. Paragraph BC84 explains the Board's decisions on individual options.

### **Staff recommendation**

55. The staff recommend that the *IFRS for SMEs* is not revised to permit the revaluation model for PPE. The aim of the *IFRS for SMEs* is to provide a standalone, simplified set of accounting principles that are appropriate for smaller non-publicly accountable entities (see paragraph 46 for full explanation). This aim should not be undermined by trying to cater for the situations in paragraph 43(c)-

(f). Amendments to the *IFRS for SMEs* should be considered based on this primary aim. It is not possible for the *IFRS for SMEs* to consider local laws/preferred accounting treatments of all the individual jurisdictions in the world. Other jurisdictions support different accounting policy options so it is difficult to permit a revaluation option, without also including other complex options.

56. Introducing options increase complexity and reduce comparability. Options increase costs for both preparers, in deciding which option to use, and users that have to examine the policy chosen and assess its effects. In some jurisdictions SMEs may be able to apply the revaluation option without significant problems. However, permitting the option may encourage SMEs in other jurisdictions to choose an accounting policy that is too complex for them, eg due to the impact on deferred tax calculations, reliable fair values not being available etc. Furthermore, SME may feel obliged to follow a more complex accounting policy option to increase their net assets, eg for comparability with their peers.
57. Staff acknowledge if entities are currently applying the revaluation model under local GAAP, a change to the cost model may have potential implications for borrowing arrangements. Certain jurisdictions have said this is a barrier to adoption. However, staff think there are other ways of reporting this information to lenders without adding complexity to the *IFRS for SMEs*, eg through additional disclosures in the financial statements or separate third party valuations. The *IFRS for SMEs* prescribes the minimum required disclosures. An SME may disclose additional information, eg the fair value of their PPE, if it would be relevant to users of the financial statements. Similarly entities experiencing high inflation may provide additional disclosures in their financial statements explaining the effects of the high inflation.

#### Question to the SMEIG

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

## Issue 6) Capitalisation of borrowing costs/development costs (Questions S10 and S14)

### Question S10) 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 must 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 (on the basis of 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.

Please provide reasoning to support your choice of (a), (b) or (c).

### Question S14) 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.

Please provide reasoning to support your choice of (a), (b) or (c).

### **Responses from comment letters**

58. Staff have included Questions S10 and S14 with the other questions in the RFI relating to accounting policy options because many comment letters suggested allowing SMEs an option to follow the full IFRSs requirements. The staff have summarised comments on Questions S10 and S14 together due to similarities in responses received.
59. Approximately 40% of comment letters responding to Question S10 (Question S14: 35%) would not change the current requirements (choice (a)). The following points cover the main reasons given:
- (a) Requirements to capitalise borrowing/development costs under full IFRSs are too complex for SMEs. For example, the judgments and estimates necessary to distinguishing the research phase from the development phase and determine when the criteria for capitalisation of development costs are met are onerous for SMEs. Similarly the judgement and calculations required in determining which borrowing costs to capitalise, and over what period, are complex. Many SMEs do not have sufficient expertise or the systems in place to apply these requirements properly and this would result in poor quality financial information.
  - (b) Requiring smaller entities to capitalise certain development/borrowing costs would increase costs without adding significant benefits to users of their financial statements. For example capitalising borrowing costs does not provide lenders with information about whether the SME can pay back the related debt.
  - (c) It is not clear why the IASB is reconsidering its decision to simplify the approach in full IFRSs for SMEs which was made because of concerns over the cost-benefit implications of requiring capitalisation. The RFI

does not provide any evidence suggesting these concerns are no longer valid.

- (d) Requiring or allowing capitalisation of development/borrowing costs will increase complexity in other areas, for example deferred taxation. Expensing development costs is in line with the income tax treatment in many jurisdictions which adds to its simplicity.
- (e) SMEs can disclose additional information about borrowing/development costs expensed in the notes to the financial statements if they believe it would be useful.
- (f) If SMEs wish to apply complex accounting requirements, and have the expertise to do so properly, they can apply full IFRSs.

60. Approximately 25% of the comment letters responding to Question S10 (Question S14: 25%) would revise the *IFRS for SMEs* to require capitalisation of borrowing and development costs meeting criteria for capitalisation in IAS 38/23 (choice (b)). Many of the reasons given are similar to those in support of aligning the *IFRS for SMEs* with new and revised IFRSs (see paragraph 39—Issue 4).

Additional reasons not covered in paragraph 39 include:

- (a) Development and borrowing costs are significant costs for some SMEs, eg start-up companies. Requiring them to be expensed can have a major impact on profits and net assets. This may reduce access to loan financing. It also makes these SMEs appear less profitable than other SMEs and puts them at a disadvantage with entities applying full IFRSs. If the *IFRS for SMEs* continues to require these expenditures to be expensed immediately it may discourage further investment needed to grow the business—for example on research and development or using borrowings to build assets, such as manufacturing plants.

61. Approximately 35% of comment letters responding to Question S10 (Question S14: 40%) chose (c) “other”. The vast majority of these comment letters suggested adding an accounting policy option for SMEs, rather than a requirement, to capitalise borrowing and development costs meeting criteria for capitalisation in IAS 38/23. Therefore SMEs would still be able to follow the

current expense approach under the *IFRS for SMEs*. This would have most of the benefits and few of the drawbacks listed in paragraph 59 and 60. The following points cover additional reasoning given:

- (a) The option would not add significant complexity to the *IFRS for SMEs* as SMEs can choose the simpler option, ie the cost model.
- (b) Although allowing options to capitalise borrowing and development costs meeting criteria for capitalisation in IAS 38/23 would reduce comparability between SMEs, it would improve comparability of SMEs with companies applying full IFRSs.
- (c) Including options in the *IFRS for SMEs* provides flexibility and makes it easier for jurisdictions to adopt the *IFRS for SMEs*. Many jurisdictions either require or permit a capitalisation approach for borrowing costs/development costs that is similar to full IFRSs. The current expense approach in the IFRS for SME is a deterrent to adoption in those jurisdictions.
- (d) If SMEs have the expertise to capitalise development/costs in accordance with IAS 23/38, they should be allowed to capitalise. SMEs should not be prohibited from providing users of financial statements with the most up to date and relevant information.

62. Paragraph 51 (Issue 5—Revaluation of PPE) covers the main reasons provided by respondents for not permitting complex options. In particular, they generally increase complexity and costs for both preparers and users.

63. Other suggestions made by comment letters include:

- (a) Require capitalisation of borrowing and development costs meeting criteria for capitalisation in IAS 38/23 if it would not result in undue cost or effort.
- (b) Simplify the criteria in IAS 38/23 for SMEs. Examples given include simplify criteria for when development costs should be capitalised and only capitalise specific borrowing costs, ie not those from a general pool of borrowings.



- (c) A number of other suggestions made by comment letters are similar to those summarised in paragraph 53 (Issue 5), ie they cover ways of including accounting policy options within the standard, eg use of separate boxed sections/appendix.

### **Staff comments**

64. Question S10 and S14 differ from Question S9 because the *IFRS for SMEs* currently requires a treatment not permitted under full IFRSs. Under Question S9 permitting an accounting policy option to use the revaluation method would be aligning the requirements of the *IFRS for SMEs* with full IFRSs (full IFRSs allows both the revaluation and cost model). Under Question S10 and S14 permitting accounting policy options to capitalise borrowing and development costs meeting criteria for capitalisation in IAS 38/23 (as well as the current expense approach) would result in more accounting policy options than full IFRSs because full IFRSs does not permit an expense-only option.
65. Paragraphs BC113-114 and B120 in the Basis for Conclusions accompanying the *IFRS for SMEs* contain the IASB reasoning for requiring all borrowing and development costs to be recognised as expenses when incurred:
- BC113 IAS 38 requires all research costs to be charged to expense when incurred, but development costs incurred after the project is deemed to be commercially viable are to be capitalised. Many preparers and auditors of SMEs' financial statements said that SMEs do not have the resources to assess whether a project is commercially viable on an ongoing basis and, furthermore, capitalisation of only a portion of the development costs does not provide useful information. Bank lending officers told the Board that information about capitalised development costs is of little benefit to them, and that they disregard those costs in making lending decisions.
- BC114 The Board accepted those views, and the *IFRS for SMEs* requires all research and development costs to be recognised as expenses when incurred.
- BC120 IAS 23 requires borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset to be capitalised as part of the cost of the asset. For cost-benefit reasons, the *IFRS for SMEs* requires such costs to be charged to expense.

**Staff recommendation**

66. The staff recommend that the *IFRS for SMEs* is not revised. The aim of the *IFRS for SMEs* is to provide a standalone, simplified set of accounting principles that are appropriate for smaller non-publicly accountable entities (see paragraph 46 for full explanation). This aim should not be undermined by trying to cater for the situations in paragraph 43(c)-(f).
67. The staff continue to support the IASB's decision and reasoning for not requiring SMEs to capitalise borrowing and development costs. Most of the respondents that support capitalisation want full alignment with full IFRSs. Therefore, staff do not support trying to simplify the criteria for capitalisation for SMEs as it would not align requirements with full IFRSs. A simplified approach would still result in additional complexity for preparers with limited benefits for users.
68. Furthermore, the staff do not support adding an accounting policy option for SMEs to capitalise borrowing and development costs meeting criteria for capitalisation in IAS 38/23. The staff reasoning is the same as provided in paragraphs 55 to 57 for not permitting a revaluation option for PPE (Issue 5).
69. The *IFRS for SMEs* requires disclosure of finance costs (paragraph 5.5(b)), disclosure of total interest expense (paragraph 11.48(b)) and aggregate amount of research and development expenditure (paragraph 18.29). The *IFRS for SMEs* prescribes the minimum required disclosures. An SME may disclose additional information, eg amount of development costs expensed, if it would be relevant to users of the financial statements.

**Question to the SMEIG**

**6a) Should Section 18 be changed to permit or require capitalisation of development costs meeting criteria for capitalisation on a similar basis to IAS 38?**

**6b) Should Section 25 of the *IFRS for SMEs* be changed so that SMEs are required to capitalise borrowing costs on a similar basis to IAS 23?**

**Issue 7) Use of recognition and measurement provisions in full IFRSs for financial instruments (Question S5)**

**Question S5) Use of recognition and measurement provisions in full IFRSs for financial instruments (Section 11)**

The *IFRS for SMEs* currently permits entities to choose to apply either (paragraph 11.2):

- the provisions of both Sections 11 and 12 in full; or
- the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement* and the disclosure requirements of Sections 11 and 12.

IAS 39 will be replaced by IFRS 9 *Financial Instruments*. Any amendments to the *IFRS for SMEs* from this comprehensive review would most probably be effective at a similar time to the effective date of IFRS 9. The *IFRS for SMEs* refers specifically to IAS 39. SMEs are not permitted to apply IFRS 9.

**How should the current option to use IAS 39 in the *IFRS for SMEs* be updated once IFRS 9 has become effective?**

- (a) There should be no option to use the recognition and measurement provisions in either IAS 39 or IFRS 9. All SMEs must follow the financial instrument requirements in Sections 11 and 12 in full.
- (b) Allow entities the option of following the recognition and measurement provisions of IFRS 9 (with the disclosure requirements of Sections 11 and 12).
- (c) Other—please explain.

Please provide reasoning to support your choice of (a), (b) or (c).

**Note:** the purpose of this question is ask whether the fallback to full IFRSs in Sections 11 and 12 should be removed completely, should continue to refer to an IFRS that has been superseded, or should be updated to refer to a current IFRS. It does not ask respondents to consider whether any of the recognition and measurement principles of IFRS 9 should result in amendments of the *IFRS for SMEs* at this stage.

**Responses from comment letters**

70. Approximately 35% of comment letters responding to Question S5 would not allow an option to use the recognition and measurement provisions in either IAS 39 or IFRS 9. They would require all SMEs to follow Sections 11 and 12 in full (choice (a)). The following points cover the main reasons given:

- (a) Introducing options increase complexity of the standard. They generally increase costs for both preparers and users of financial statements. They also reduce comparability between SMEs.
- (b) The *IFRS for SMEs* should be a self-contained, standalone standard with no fallbacks to full IFRSs. There is no reason to have an exception for financial instruments. Any options or requirements considered appropriate for SMEs should be incorporated in the *IFRS for SMEs*, not

via a cross-reference to full IFRSs. Once IFRS 9 is effective, it may be appropriate to update Section 11 and 12 to incorporate its requirements, modified as appropriate for SMEs.

- (c) Requirements in IFRS 9 are too complex for SMEs. Many SMEs do not have sufficient expertise or resources to apply these requirements properly and it would result in poor quality financial information if they decided to apply IFRS 9.
- (d) If SMEs have the capability and want to apply complex accounting requirements, eg IFRS 9 they can apply full IFRSs.
- (e) Based on our experience of use of the *IFRS for SMEs* (in South Africa), few SMEs are using the fallback to IAS 39 except for subsidiaries that produce full IFRSs information for consolidation purposes.

71. Approximately 50% of the comment letters responding to Question S5 would allow SMEs the option of following the recognition and measurement provisions of IFRS 9 (with the disclosure requirements of Sections 11 and 12) (choice (b)). However, some supporters of an option to use IFRS 9 suggest waiting until IFRS 9 is established and the post-implementation review of IFRS 9 is completed. In contrast, others think the fallback to full IFRSs must be updated as soon as IFRS 9 becomes effective as it would not make sense to fallback to IAS 39 once it has been superseded. Many of the reasons given for allowing a fallback option to full IFRSs are similar to the reasons given for aligning the *IFRS for SMEs* with new and revised IFRSs (see paragraph 39 – Issue 4), allowing SMEs an option to revalue PPE (paragraph 52—Issue 5), and permitting or requiring SMEs to capitalise borrowing/development costs (paragraph 60 and 61—Issue 6). Additional reasons not covered under Issues 4-6 include:

- (a) A fallback to IFRS 9 is necessary due to the wide spectrum of entities of different sizes and legal forms applying full IFRSs. Some SMEs have complex financial instrument transactions and it would be more appropriate for these entities to be able to use the fallback to full IFRSs. If the scope of the *IFRS for SMEs* is extended to include small financial

institutions (Question S2) then an option to fallback to IFRS 9 is even more important.

- (b) The reasons for permitting an option to use full IFRSs for financial instruments as stated in BC106 of the Basis for Conclusions remain valid.
- (c) Compared with IAS 39, IFRS 9 is more consistent with Sections 11 and 12. Hence, a fallback to IFRS 9 will lead to more comparability with SMEs applying Section 11 and 12 than the previous fallback to IAS 39.
- (d) The *IFRS for SMEs* should not make reference to a full IFRS standard that has been superseded. The target effective date of the revisions to the *IFRS for SMEs* coincides with the effective date of IFRS 9. If the option to apply IAS 39 is not changed to IFRS 9, the IASB will have to maintain IAS 39 only for SMEs or force all SMEs using IAS 39 to apply Sections 11/12. Preparers who have elected to use IAS 39, may also want the option to use IFRS 9 for the same reasons that had for using IAS 39.

72. Approximately 15% of comment letters responding to Question S5 chose (c) “other”. Other suggestions made by comment letters include:

- (a) Before removing the option to fallback to full IFRSs, it is necessary to review the IASB’s reasons in BC106 for permitting the option. The IASB should also perform outreach to see to what extent entities are using the fallback in practice, and for what reasons.
- (b) The IASB should incorporate the requirements of IFRS 9 (modified appropriately for SMEs) into Sections 11 and 12 when IFRS 9 has been implemented under full IFRSs and the post-implementation review has been concluded. Once this has been done the fallback to full IFRSs can be removed. In the interim period (ie until the next triennial review of the *IFRS for SMEs* is carried out) the fallback to IAS 39/IFRS 9 should remain to ensure consistency of application by SMEs.

- (c) The wording in Section 11 should be revised to refer to “current full IFRS for financial instruments”. The fallback to IAS 39 should be replaced by IFRS 9 when IFRS 9 becomes effective.
- (d) IFRS 9 should be fully completed and not likely to change again before it is permitted for use by SMEs. Until that time the fallback to IAS 39 should remain.
- (e) The fallback to IAS 39 should be updated to IFRS 9 as an interim solution. Once IFRS 9 becomes established under full IFRSs the IASB should consider whether to incorporate the requirements into Section 11.

### **Staff comments**

73. Paragraphs BC106 in the Basis for Conclusions accompanying the IFRS for SMEs contain the IASB reasoning for permitting SMEs a choice of following Sections 11 and 12 or IAS 39 in accounting for all of their financial instruments:

BC106 The *IFRS for SMEs* gives SMEs a choice of following Sections 11 and 12 or IAS 39 in accounting for all of their financial instruments. The Board’s reasons for proposing that choice in this case are as follows:

- (a) Although Sections 11 and 12 are a simpler approach to accounting for financial instruments than IAS 39, some of the simplifications involve eliminating options that are available to companies with public accountability under IAS 39, for instance:
  - (i) the fair value option.
  - (ii) available-for-sale classification and the available-for-sale option.
  - (iii) held-to-maturity classification.
  - (iv) a continuing involvement approach to derecognition (ie partial derecognition).
  - (v) the use of hedge accounting for hedges other than the four specific types identified in paragraph BC101(c).

The Board is currently reconsidering IAS 39 in its entirety and concluded that SMEs should be permitted to have the same accounting policy options as in IAS 39 pending completion of the comprehensive IAS 39 project.

- (b) Because the default category for financial instruments in the scope of Section 12 is fair value through profit and loss under the *IFRS for SMEs*, and cost or amortised cost is permitted only when specified conditions are met, some items measured at cost or amortised cost under IAS 39 because of their nature would be measured at fair value through profit or loss under

the *IFRS for SMEs*. Some SMEs might find this added fair valuation burdensome.

- (c) Sometimes, an entity makes what it views as a ‘strategic investment’ in equity instruments issued by another entity, with the intention of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. Those entities generally believe that the available-for-sale classification of IAS 39 is appropriate to account for strategic investments. Under the *IFRS for SMEs*, however, these strategic investments would be accounted for either at fair value through profit or loss or at amortised cost.
- (d) The derecognition provisions of the *IFRS for SMEs* would not result in derecognition for many securitisations and factoring transactions that SMEs may enter into, whereas IAS 39 would result in derecognition

### **Staff recommendation**

- 74. The staff recommendation for dealing with changes to new and revised IFRSs is set out in paragraphs 46-49 (Issue 4). In line with that recommendation, staff recommend that IFRS 9 should only be considered as a basis for amending Section 11 and 12 after it has become established under full IFRSs and implementation experience under full IFRSs has been assessed (eg after the post-implementation review has been performed).
- 75. Consistent with the aim to provide a standalone, simplified set of accounting principles that are appropriate for smaller non-publicly accountable entities (see paragraph 46 for full explanation), the staff would prefer the fallback to IAS39/IFRS 9 be ultimately removed. However, staff recommend that the fallback is retained until IFRS 9 is considered. One of the main reasons for permitting a fallback to IAS 39 is the IASB felt that SMEs should be permitted to have the same accounting policy options as in IAS 39 pending completion of the IAS 39 project and this argument remains valid.
- 76. Where entities are currently applying IAS 39, it does not seem appropriate to require them to change to Section 11 and 12 when it is likely those sections will be amended during the next review.
- 77. The staff think most SMEs, except subsidiaries of full IFRSs groups, will find the fallback to full IFRSs onerous and will choose to follow Sections 11 and 12 in

full. However, without evidence that this is the case the staff does not believe the fallback to full IFRSs should be removed during this review.

78. In summary, staff propose that no change is made to Section 11 and 12 to incorporate the requirements of IFRS 9. Staff propose that the fallback to IAS 39 remains for the time being and is amended to refer to the IFRS standard that is in effect at the entity's reporting date.

#### Question to the SMEIG

**7) How should the current option to use IAS 39 in the *IFRS for SMEs* be updated once IFRS 9 has become effective?**

## Income tax

### Introduction

79. There are three questions in the RFI about income tax. The staff suggest the SMEIG discuss these questions together and develop recommendations for the IASB on how to update Section 29 of the *IFRS for SMEs*. The following questions in the RFI relate to income tax:

- (a) Approach for accounting for deferred income taxes (Question S16)
- (b) Consideration of IAS 12 exemptions from recognising deferred taxes and other differences under IAS 12 (Question S17)
- (c) Rebuttable presumption that investment property at fair value is recovered through sale (Question S18)

### ***Issue 8) Income Tax (Questions S16-S18)***



**Question S16) 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 for SMEs. 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.

Please provide reasoning to support your choice of (a), (b), (c), (d) or (e).

**Question S17) Consideration of IAS 12 exemptions from recognising deferred taxes and other differences under IAS 12 (Section 29)**

In answering this question, please assume that SMEs will continue to recognise deferred income taxes using the temporary difference method (see discussion in question S16).

Section 29 is based on the IASB’s March 2009 exposure draft *Income Tax*. At the time the *IFRS for SMEs* was issued, that exposure draft was expected to amend IAS 12 *Income Taxes* by eliminating some exemptions from recognising deferred taxes and simplifying the accounting in other areas. The IASB eliminated the exemptions when developing Section 29 and made the other changes in the interest of simplifying the *IFRS for SMEs*.

Some interested parties who are familiar with IAS 12 say that Section 29 does not noticeably simplify IAS 12 and that the removal of the IAS 12 exemptions results in more deferred tax calculations being required. Because the March 2009 exposure draft was not finalised, some question whether the differences between Section 29 and IAS 12 are now justified.

**Should Section 29 be revised to conform it to IAS 12, modified as appropriate to reflect the needs of the users of SME financial statements?**

- (a) No—do not change the overall approach in Section 29.

(b) Yes—revise Section 29 to conform it to the current IAS 12 (modified as appropriate for SMEs).

(c) Other—please explain.

Please provide reasoning to support your choice of (a), (b) or (c).

**Question S18) Rebuttable presumption that investment property at fair value is recovered through sale (Section 29)**

In answering this question, please also assume that SMEs will continue to recognise deferred income taxes using the temporary difference method (see discussion in question S16).

In December 2010, the IASB amended IAS 12 to introduce a rebuttable presumption that the carrying amount of investment property measured at fair value will be recovered entirely through sale.

The amendment to IAS 12 was issued because, without specific plans for the disposal of the investment property, it can be difficult and subjective to estimate how much of the carrying amount of the investment property will be recovered through cash flows from rental income and how much of it will be recovered through cash flows from selling the asset.

Paragraph 29.20 currently states:

“The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover or settle the carrying amount of the related assets and liabilities.”

**Should Section 29 be revised to incorporate a similar exemption from paragraph 29.20 for investment property at fair value?**

(a) No—do not change the current requirements. Do not add an exemption in paragraph 29.20 for investment property measured at fair value.

(b) Yes—revise Section 29 to incorporate the exemption for investment property at fair value (the approach in IAS 12).

(c) Other—please explain.

Please provide reasoning to support your choice of (a), (b) or (c).

**Responses from comment letters**

*Question S16*

80. Approximately 55% of comment letters responding to Question S16 support SMEs recognising deferred income taxes using the temporary difference method (choice (a)—the approach currently used in both the *IFRS for SMEs* and full IFRSs). The reasons given are similar to those summarised in paragraph 39 for aligning the *IFRS for SMEs* with new and revised IFRSs (Issue 4). Additional reasons not covered in paragraph 39 include:

- (a) The temporary difference method provides useful information to users of the financial statements.
- (b) In many jurisdictions SMEs have been applying a temporary difference approach for a long time. Consequently, preparers and users of SME financial statements understand it. There is significant implementation experience and education material in these jurisdictions for SMEs around the world to refer to.
- (c) The temporary difference method is generally understandable and not too complicated for the SME market. Tax balance sheets are available in many cases.
- (d) Replacing the temporary difference method with either the timing difference method or the liability method is unlikely to result in any improvement as both methods are complex and involve judgement. Plus this would result in further divergence from full IFRSs.

81. Approximately 20% of comment letters responding to Question S16 believe SMEs should not recognise deferred income taxes at all, ie they should use the taxes payable method (choice (d)), although some related disclosures should be required. The following points cover the main reasons given:

- (a) The taxes payable method is simple to understand and apply by preparers and users of financial statements. It would allow users of financial statements to easily see the amount of tax payable by the SME and providing a significant time and cost saving for SMEs.
- (b) It is possible to provide stakeholders with information about the entity's income taxes in the notes to the financial statements without requiring the temporary difference model. For example, disclosures explaining the change in the effective tax rate year over year (to understand why tax rate is fluctuating) and the implications of temporary differences that will affect the amount paid to/recovered from the tax authorities.
- (c) The temporary difference method is too complex for SMEs and errors are frequently made, reducing the quality of the financial information.

The benefits of deferred tax information for users of financial statements has been shown to be questionable and many users do not understand the information provided.

- (d) Particularly for entities that are small in size the costs of recognising deferred tax outweigh the benefits to users of their financial statements.

82. There was very limited support for other methods (approximately 5%), eg the timing difference method or liability method (choice (b,c)). Approximately 20% of comment letters responding to Question S16 chose (e) “other”. Other suggestions made by comment letters include:

- (a) Other methods such as the taxes payable method and the timing difference method may be simpler and more understandable than the temporary difference method. However, before such a significant change is made to the *IFRS for SMEs*, the costs and benefits of the different methods should be assessed from the perspective of SMEs and users of their financial statements. Further outreach and field testing should be performed. Until this is done the temporary difference model should be retained.
- (b) When considering whether alternative approaches to income tax should be considered for SMEs, the IASB should consider the work done by the European Financial Reporting Advisory Group (EFRAG) and the UK standard setter, the UK Accounting Standards Board (ASB), in particular the Discussion Paper *Improving the Financial Reporting of Income Tax*.
- (c) Permit SMEs an option of either using the temporary difference method or the taxes payable method.
- (d) A timing difference plus approach is used in the UK version of the *IFRS for SMEs*.

### Question S17

83. Question S17 assumed that SMEs will continue to recognise deferred income taxes using the temporary difference method. Only about 10% of comment letters

responding to Question S17 thought that there was no need to revise the overall approach in Section 29 (choice (a)). The reasons given include Section 29 not causing problems in practice and it being difficult to simplify IAS 12 sufficiently for SMEs.

84. Approximately 75% of comment letters responding to Question S17 would revise Section 29 to conform it to the current IAS 12 modified as appropriate to reflect the needs of the users of SME financial statements (choice (b)). The reasons given are similar to those summarised in paragraph 39 for aligning the *IFRS for SMEs* with new and revised IFRSs (Issue 4). Additional reasons not covered in paragraph 39 include:

- (a) Section 29 does not simplify the approach in IAS 12. Consequently, it would be better to align Section 29 with full IFRSs to avoid unnecessary differences with full IFRSs rather than base it on an exposure draft that was never finalised.
- (b) It could be argued Section 29 is more complex than IAS 12 because the removal of the IAS 12 exemptions results in more deferred tax calculations being required.
- (c) Section 29 should be revised for the same reasons that the March 2009 exposure draft was rejected.
- (d) IAS 12 has been applied by entities, including SMEs, for many years and so it is better understood than the approach in Section 29. If Section 29 is revised to conform it to the current IAS 12, SMEs may use the experience of entities currently applying the requirements under full IFRSs and the extensive education material on IAS 12 to help them understand the requirements. It is more difficult to transfer this experience and knowledge to SMEs when requirements are not similar to IAS 12.
- (e) A number of jurisdictions have replaced Section 29 by the recognition and measurement requirements in IAS 12 when adopting their own version of the *IFRS for SMEs*, eg Hong Kong and the UK.

85. Approximately 15% of comment letters responding to Question S17 chose (c) “other”. Most of these comment letters chose not to answer Question S17 directly. Instead they emphasised that both Section 29 and IAS 12 are too complex for SMEs.

### *Question S18*

86. Question S18 assumed that SMEs will continue to recognise deferred income taxes using the temporary difference method. Approximately 15% of comment letters responding to Question S18 think the overall approach in Section 29 should be left unchanged (choice (a)). However, approximately 75% would revise Section 29 to incorporate a rebuttable presumption that the carrying amount of investment property measured at fair value will be recovered entirely through sale (choice (b)). Question S18 asks whether the *IFRS for SMEs* should incorporate revisions made to IAS 12 in December 2010. Therefore, comments received were similar to those summarised in paragraphs 37-40 for new and revised IFRSs (Issue 4). However, there was slightly more support for incorporating a rebuttable presumption under Question S18 than for other changes in new and revised IFRSs. This is because many respondents felt that such a rebuttable presumption is consistent with the aim of the *IFRS for SMEs* because it would result in a simplification for SMEs. Some respondents noted that many entities have adopted the amendment to IAS 12 early and it has proven to be useful. Approximately 10% of comment letters responding to Question S18 chose (c) “other”. Most of these comment letters chose not to answer Question S17 directly. Instead they emphasised that both Section 29 and IAS 12 are too complex for SMEs

### **Staff comments**

87. Paragraphs BC121, BC122 and BC145 in the Basis for Conclusions accompanying the *IFRS for SMEs* contain the IASB reasoning for choosing the current approach for income taxes:

BC121 In their responses to the questionnaire and at the round-table meetings, many preparers and auditors of SMEs’ financial statements said that the temporary difference approach to accounting for income taxes in IAS 12 *Income Taxes* is

difficult for SMEs to implement. They said that SMEs do not routinely prepare ‘tax balance sheets’ and generally do not track the tax bases of many assets. Some advocated a ‘current taxes payable’ method of accounting for income taxes, under which SMEs would not recognise deferred taxes

BC122 The Board did not support the ‘current taxes payable’ approach for the reasons explained in paragraph BC145. However, while believing that the principle of recognising deferred tax assets and liabilities is appropriate for SMEs, the Board also concluded that implementation of that principle could be simplified for SMEs. Section 29 *Income Tax* of the *IFRS for SMEs* uses the approach set out in the Board’s exposure draft *Income Tax*, published in March 2009, which proposes a simplified replacement for IAS 12. The only significant measurement difference in the *IFRS for SMEs* as compared with the exposure draft *Income Tax* is where a different tax rate applies to distributed and undistributed income. The *IFRS for SMEs* requires current and deferred taxes to be measured initially at the rate applicable to undistributed profits, with adjustment in subsequent periods if the profits are distributed. The *Income Tax* exposure draft would initially measure current and deferred taxes at the tax rate expected to apply when the profits are distributed.

BC145 Some support the ‘taxes payable method’ of accounting for income taxes. Under that method, only income taxes currently payable or refundable are recognised; deferred taxes are not recognised. Many users of SMEs’ financial statements disagree with the taxes payable method. They point out that deferred taxes are liabilities (or sometimes assets) that can result in large outflows (inflows) of cash in the near future and, therefore, should be recognised. Even those users of financial statements who do not agree that deferred tax liabilities or deferred tax assets should be recognised generally want the amounts, causes and other information disclosed in the notes. Note disclosure would entail the same tracking and computation effort for SMEs as would recognition, but would be inconsistent with the principles for recognising assets and liabilities in the *Framework*. The Board concluded that making a fundamental departure from the recognition principles in IAS 12 while requiring disclosure of the information that users of SMEs’ financial statements find useful is not justified on a cost-benefit basis. Moreover, the Board believes that deferred taxes satisfy the requirements for recognition as assets and liabilities and can be measured reliably.

### **Staff recommendation**

88. There is significant support from respondents for retaining a temporary difference approach and basing Section 29 on IAS 12. Therefore, the staff recommend Section 29 is revised to conform it to IAS 12, modified as appropriate to reflect the needs of users of SME financial statements. Staff think it would be better to base Section 29 on the approach in IAS 12, rather than on an exposure draft that was never finalised. IAS 12 has been applied by entities, including SMEs, in many jurisdictions for years. SMEs may use this experience and the education material available to understand the requirements if they are based on IAS 12.

89. On the other hand, many SMEs and users of their financial statements are not familiar with the approach in IAS 12. Many SMEs would find it costly and complex to apply an approach based on IAS 12 even using the experience of other entities around the world. Therefore whilst staff recommend Section 29 is revised to conform it to IAS 12 (modified accordingly), staff would like to explore further ways of introducing a simplification for these SMEs.
90. In general, the staff does not support adding options to the *IFRS for SMEs*. Consequently staff does not propose including an option for entities to apply the taxes payable method. However, staff would welcome suggestions from SMEIG members on whether it would be workable to add an undue cost or effort exemption for some or all the requirements in Section 29 (revised to align with IAS 12). For example, if an SME cannot apply the requirements in Section 29 without undue cost or effort it would be permitted to apply a taxes payable approach (or tax payable plus approach) with additional disclosures, eg of the implications of temporary differences that will affect the amount paid to the tax authorities.
91. Exemptions for ‘undue cost or effort’ are already used in many section of the *IFRS for SMEs*—for example measurement of investment property at fair value (paragraph 16.7), use of the projected unit credit method to measure the defined benefit obligation (paragraph 28.18) and recognition of deferred tax assets and liabilities on transition (paragraph 35.10(h)).
92. The staff recommendation for changes to new and revised IFRSs is set out in paragraphs 46-49. In general, staff prefer that new and revised IFRSs are only considered for incorporation after they are established under full IFRSs and implementation experience has been assessed. However, in this case, staff propose that the recent amendment to IAS 12 to add a rebuttable presumption that the carrying amount of investment property measured at fair value will be recovered entirely through sale should be incorporated for two reasons:
- (a) Many entities applying full IFRSs have adopted the amendments early and found that the rebuttable presumption results in a simplification and



reduces subjectivity. The IASB will not be performing a post-implementation review for such a small amendment to IAS 12.

- (b) If Section 29 is revised to conform it to IAS 12, it makes sense to include all amendments at the same time. This will avoid amending Section 29 again at the next triennial review.

93. In summary staff recommend that Section 29 is aligned with IAS 12 (including adding a rebuttable presumption for investment property at fair value), modified as appropriate to reflect the needs of users of SME financial statements. The staff would also like to explore ways of providing relief from the requirements if they result in undue cost or effort.

#### Question to the SMEIG

**8a) Should SMEs recognise deferred income taxes and, if so, how should it be recognised?**

**Assuming a temporary difference approach is followed for SMEs:**

- **8b) Should Section 29 be revised to conform it to IAS 12, modified as appropriate to reflect the needs of the users of SME financial statements?**
- **8c) Should Section 29 include an ‘undue cost or effort’ exemption for some or all of its requirements?**
- **8d) Should Section 29 be revised to incorporate a rebuttable presumption that the carrying amount of investment property measured at fair value will be recovered entirely through sale?**

## Two issues on specific paragraphs in the *IFRS for SMEs*

### Issue 9) Amortisation period for goodwill and other intangible assets

#### (Question S11)

#### Question S11) 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 to 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.

Please provide reasoning to support your choice of (a), (b) or (c).

### **Responses from comment letters**

94. Approximately 30% of comment letters responding to Question S11 would not change the current requirements (choice (a)). They would 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). The following points cover the main reasons given:

- (a) Changing the wording as proposed under option (b) is unlikely to have any effect because if a shorter period can be justified, a reliable estimate of useful life can probably be made.
- (b) If management cannot estimate the useful life reliably it should be presumed to be ten years. This enhances comparability of financial statements.
- (c) The current requirement causes a difference between EU directives and the *IFRS for SMEs*. However the *IFRS for SMEs* should not be amended at the request of certain regions to align with local laws/regulation as different regions will have different requests. Amendments should be considered under the objectives of the *IFRS for SMEs* (eg needs of users of SME financial statements and cost-benefit considerations).

95. Approximately 40% of comment letters responding to Question S11 would modify paragraph 18.20 to establish a presumption of ten years that can be overridden if a shorter period can be justified (choice (b)). The following points cover the main reasons given:

- (a) Sometimes a ten year period is too long (eg in difficult economic times). In cases where management is unable to make a reliable estimate of the useful life of an intangible asset, there may be indicators that the useful life is less than 10 years. In this situation it would be better to use management's best estimate than use the default life. This would prevent goodwill being overstated and prevent later impairment charges. The entity should provide disclosure of the basis for the estimate.
- (b) The problem with including ten years as the default useful life is entities will use it as an automatic default instead of trying to establish a basis for making an estimate of the useful life.
- (c) A presumption of 10 years is arbitrary and may not be true in many cases. Consequently it would not always provide useful information to users of financial statements. Allowing a shorter amortisation period as proposed will allow more flexibility for management to exercise judgement.
- (d) Modifying paragraph 18.20 to allow a shorter period if it can be justified would eliminate a difference with the new EU directives which requires goodwill to be written off over a maximum life of five years unless a longer life can be supported.

96. A few letters said the proposal in Question S11 is not clear:

- (a) If an entity is unable to make a reliable estimate of a useful life, then it seems counterintuitive that it is capable of justifying a shorter life than 10 years.
- (b) If a shorter period than 10 years can be justified, it is not clear whether the entity has to estimate the life (even if they are unable to do so reliably) or whether it has a free choice over any period from 1-9 years.
- (c) Additional guidance is needed on 'reliable estimate' and 'can be justified' to ensure entities do not default automatically to ten years. Provide examples of the factors that SME would have to consider to

justify a shorter life, eg expectation of typical life cycles for similar assets, expectations of technical obsolescence, etc.

97. Approximately 30% of comment letters responding to Question S11 chose (c) “other”. Alternative suggestions made by comment letters include:
- (a) Paragraph 18.20 should be deleted. The *IFRS for SMEs* requires entities to make best estimates in several other sections with no default amount prescribed. The useful life of intangibles should be treated in the same way.
  - (b) Goodwill should not be amortised for consistency with full IFRSs. Alternatively an option should be added to permit entities to follow an impairment only approach like full IFRSs.
  - (c) The useful life of goodwill is often shorter than 10 years. It would be better to have a shorter default, such as five years. A longer period could be allowed in rare circumstances if the entity can demonstrate conditions that justify a longer useful life.
  - (d) If the *IFRS for SMEs* allows a period shorter than 10 years to be used if it can be justified, it should also allow a period longer than 10 years to be used if it can be justified.
  - (e) Consider rewording paragraph 18.20 to specify that if the entity is unable to make a reliable estimate of the useful life of an intangible asset, the useful life shall be presumed to be not more than ten years. Alternatively, reword to state that the useful life should be management’s best estimate.

### **Staff recommendation**

98. Staff suggest modifying paragraph 18.20 to state “If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the useful life shall be determined based on management's best estimate and shall not exceed 10 years”. This wording would achieve the same intended result as option (b), but it is clearer. SMEs are required to make best estimates in many other sections of the

*IFRS for SMEs*, eg Section 21 *Provisions and Contingencies*, and so this wording will be understood. The revised wording also responds to the concerns raised by respondents in paragraph 96.

99. Although a default useful life of 10 years is simple, it does not provide users of financial statements with any information about the period over which an asset is expected to be available for use. Requiring management to use their best estimate is unlikely to require additional work because paragraph 18.20 already requires management to assess if a reliable estimate of the life is possible. Management's best estimate is likely to result in better information for users of the financial statements than a default life provided disclosure of the basis is provided.

#### Question to the SMEIG

9) Should paragraph 18.20 be modified?

### Issue 10) Presentation of share subscriptions receivable (Question S13)

#### Question S13) Presentation of share subscriptions receivable (Section 22)

Paragraph 22.7(a) requires that subscriptions receivable, and similar receivables that arise when equity instruments are issued before the entity receives the cash for those instruments, must be offset against equity in the statement of financial position, not presented as an asset.

Some interested parties have told the IASB that their national laws regard the equity as having been issued and require the presentation of the related receivable as an asset.

**Should paragraph 22.7(a) be amended either to permit or require the presentation of the receivable as an asset?**

- (a) No—do not change the current requirements. Continue to present the subscription receivable as an offset to equity.
- (b) Yes—change paragraph 22.7(a) to require that the subscription receivable is presented as an asset.
- (c) Yes—add an additional option to paragraph 22.7(a) to permit the subscription receivable to be presented as an asset, ie the entity would have a choice whether to present it as an asset or as an offset to equity.
- (d) Other—please explain.

Please provide reasoning to support your choice of (a), (b), (c) or (d).

**Responses from comment letters**

100. Approximately 30% of comment letters responding to Question S13 would not change the current requirements (choice (a)). They would continue to present the subscription receivable as an offset to equity. The following points cover the main reasons given:
- (a) The *IFRS for SMEs* should not be amended at the request of certain regions. It is not possible for the *IFRS for SMEs* to consider local laws/regulation of all the individual jurisdictions in the world. Amendments should be considered under the objectives of the *IFRS for SMEs*.
  - (b) Current requirements are clear and simple to apply. It is preferable to require presentation as an offset to equity for practical reasons as it avoids the need to assess whether the receivable meets the definition of a financial asset.
  - (c) Presentation in equity better presents the substance of the share subscription receivable.
101. Approximately 10% of comment letters responding to Question S13 would change paragraph 22.7(a) to require that the subscription receivable is presented as an asset (choice (b)). The reason given by most of these respondents is that the share subscription receivable meets the definition of an asset and so it is not appropriate to show it as an adjustment to equity.
102. Approximately 20% of comment letters responding to Question S13 would add an additional option to paragraph 22.7(a) to permit the subscription receivable to be presented as an asset, ie the entity would have a choice whether to present it as an asset or as an offset to equity (choice (c)). The reason given by most of these respondents is an option would allow entities to present their subscription receivable as an asset or offset to equity depending on the jurisdiction laws.
103. Approximately 40% of comment letters responding to Question S13 chose (d) “other”. Most of these respondents did not support any of the choices (a) to (c) provided in Question S13. The following points cover the main reasoning given:

- (a) Paragraph 22.7(a) should be deleted as it is not in full IFRSs. It is not appropriate for the *IFRS for SMEs* to stipulate the treatment of transactions on which full IFRSs is silent and subject to legal requirements in a number of jurisdictions.
- (b) Paragraph 22.7(a) should be revised to require an assessment based on the substance of the arrangement. Determination of whether the subscription receivable is an asset or an offset against equity depends on the facts and circumstances and whether the subscription receivable meets the definition and recognition criteria of an asset.
- (c) The subscription receivable should be presented as a receivable (no offsetting) when the following criteria are met:
  - (i) equity instruments provide holder with the same rights as equity instruments that have been fully paid; and
  - (ii) entity has an enforceable right to consideration to be received in exchange for the equity instruments
- (d) This issue should be investigated further before a change in made. The IASB should explore whether benefits from amending 22.7(a) to permit or require presentation of the receivable, eg compliance with national laws, exceed the costs, eg lack of consistent treatment.

### **Staff recommendation**

104. Staff recommend deleting paragraph 22.7(a). It was added to provide additional guidance and to simplify requirements. However, most respondents object to the current paragraph and reasons given are much wider than a conflict with legal requirements in some jurisdictions.

#### **Question to the SMEIG**

**10) Should paragraph 22.7(a) be modified or deleted?**

## Remaining issues

### Issue 11) Inclusion of additional topics in the *IFRS for SMEs* (Question S19)

#### Question S19) Inclusion of additional topics in the *IFRS for SMEs*

The IASB intended that the 35 sections in the *IFRS for SMEs* would cover the kinds of transactions, events and conditions that are typically encountered by most SMEs. The IASB also provided guidance on how an entity's management should exercise judgement in developing an accounting policy in cases where the *IFRS for SMEs* does not specifically address a topic (see paragraphs 10.4–10.6).

**Are there any topics that are not specifically addressed in the *IFRS for SMEs* that you think should be covered (ie where the general guidance in paragraphs 10.4–10.6 is not sufficient)?**

- (a) No.
- (b) Yes (please state the topic and reasoning for your response).

### **Suggestions from comment letters**

105. Only a few comment letters suggested adding additional topics to the *IFRS for SMEs*. The following are the suggestions made by two or more comment letters:
- (a) Segment information, eg based on IFRS 8 *Operating Segments*.
  - (b) Interim financial reporting, eg based on IAS 34 *Interim Reporting*.
  - (c) Earnings per Share, eg based on IAS 33 *Earnings per Share*.
  - (d) Incorporate requirements for non-current assets held for sale based on IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to align with full IFRSs.
  - (e) Accounting for grant income from non-government grants. Non-governmental organisations represent a significant sector in many emerging markets but the *IFRS for SMEs* doesn't contain requirements for non-government grants (the bulk of their resources).
  - (f) A section containing addition guidance and disclosure requirements to address issues specific to NFP entities.



**Staff comments**

106. Paragraphs 10.4-10.6 of the *IFRS for SMEs* contains guidance if the *IFRS for SMEs* does not specifically address a transaction, other event or condition:
- 10.4 If this IFRS does not specifically address a transaction, other event or condition, an entity's 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.
- 10.5 In making the judgement described in paragraph 10.4, management shall refer to, and consider the applicability of, the following sources in descending order:
- (a) the requirements and guidance in this IFRS 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*.
- 10.6 In making the judgement described in paragraph 10.4, management may also consider the requirements and guidance in full IFRSs dealing with similar and related issues.
107. Paragraphs BC118 and BC119 of the *IFRS for SMEs* explain why the IASB simplified requirements for non-current assets held for sale:
- BC118 IFRS 5 defines when non-current assets or groups of assets (and associated liabilities) are 'held for sale' and establishes accounting requirements for such assets. The accounting requirements are, in essence, (a) stop depreciating the asset (or assets in the group) and (b) measure the asset (or group) at the lower of carrying amount and fair value less costs to sell. There is also a requirement to disclose information about all non-current assets (groups) held for sale. The exposure draft of the *IFRS for SMEs* had proposed nearly identical requirements.
- BC119 Many respondents to the exposure draft recommended that the *IFRS for SMEs* should not have a separate held-for-sale classification for cost-benefit reasons, and working group members concurred. They felt that an accounting result similar to that of IFRS 5 could be achieved more simply by including intention to sell as an indicator of impairment. Many who held this view also recommended that the *IFRS for SMEs* require disclosure when an entity has a binding sale agreement for a major disposal of assets, or a group of assets or liabilities. The Board agreed with those recommendations because (a) the impairment requirements in the IFRS would ensure that assets are not overstated in the financial statements and (b) the disclosure requirements will provide relevant information to users of SMEs' financial statements.

**Staff recommendation**

108. Staff do not recommend adding additional topics to the *IFRS for SMEs* for the suggestions in the comment letters.
109. Staff do not recommend adding requirements for segment information, interim financial reporting and earnings per share. When the IFRS for SMEs was issued, the IASB did not include requirements in these three areas because the information is generally not relevant to users of SME financial statements. The *IFRS for SMEs* prescribes minimum required disclosures. An SME may disclose additional information if it thinks it is relevant to users of the financial statements, eg segment information and earnings per share figures. Alternatively it may choose (or be required by local law) to produce interim financial statements. An entity may choose to refer to full IFRSs (eg IAS 34 and IFRS 8) under the general guidance in paragraphs 10.5–10.6 if it prepares such information.
110. Most respondents suggesting adding requirements on non-current assets held for sale did so because they support aligning the IFRS for SMEs with full IFRSs. Staff continue to support the IASB decision and reasoning in paragraphs BC118–119. The primary aim of the *IFRS for SMEs* is to provide a standalone, simplified, set of accounting principles that are appropriate for smaller non-publicly accountable entities (see paragraph 46), not to align requirements with full IFRSs to cater for the situations in paragraph 43(c)-(f).
111. Staff do not think it is necessary to add additional guidance for non-governmental grant income. By analogy, grants received from non-governmental agencies would be accounted for similarly to governmental grants (paragraphs 10.4-10.5).
112. The *IFRS for SMEs* and full IFRSs are aimed at the for-profit sector and do not consider the unique needs of NFP entities. The fact there are no special considerations in *IFRS for SMEs* for NFP entities does not imply it is inappropriate for them. However, to add a section providing guidance the address the specific issues related to NFP entities would be time consuming and would go beyond full IFRSs. The IASB will consider whether to address the special issues of NFP entities under full IFRSs/the *IFRS for SMEs* at a later date.

**Question to the SMEIG**

**11) Are there any topics that are not specifically addressed in the *IFRS for SMEs* that should be covered (ie where the general guidance in paragraphs 10.4–10.6 is not sufficient)?**

**SMEIG Q&As****Introduction**

113. There are two questions in the RFI about the SMEIG Q&As programme. The staff suggest the SMEIG discuss these two questions together and develop a recommendation for the IASB on if, and if so how, the current Q&A programme should be continued and how the existing Q&As should be dealt with during this comprehensive review. The following questions in the RFI relate to Q&As:
- (a) Further need for Q&As (Question G2)
  - (b) Treatment of existing Q&As (Question G3)

**Issue 12) SMEIG Q&As (Questions G2 and G3)****Question G2) 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). The SMEIG Q&A programme has been limited. Only seven final Q&As 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 by 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 creating 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.

Please provide reasoning to support your choice of (a), (b) or (c).

**Question G3) Treatment of existing Q&As**

This comprehensive review provides an opportunity for the guidance in those Q&As to be incorporated into the *IFRS for SMEs* and for the Q&As to be deleted.

Non-mandatory guidance from the Q&As will become mandatory if it is included as requirements in the *IFRS for SMEs*. In addition, any guidance may need to be incorporated in the *IFRS for SMEs* in a reduced format or may even be omitted altogether (if the IASB deems that the guidance is no longer applicable after the Standard is updated or that the guidance is better suited for inclusion in training material). The IASB would also have to decide whether any parts of the guidance that are not incorporated into the *IFRS for SMEs* should be retained in some fashion, for example, as an addition to the Basis for Conclusions accompanying the *IFRS for SMEs* or as part of the training material on the *IFRS for SMEs*.

An alternative approach would be to continue to retain the Q&As separately where they remain relevant to the updated *IFRS for SMEs*. Under this approach there would be no need to reduce the guidance in the Q&As, but the guidance may need to be updated because of changes to the *IFRS for SMEs* resulting from the comprehensive review.

**Should the Q&As be incorporated into the *IFRS for SMEs*?**

- (a) Yes—the seven final Q&As should be incorporated as explained above, and deleted.
- (b) No—the seven final Q&As should be retained as guidance separate from the *IFRS for SMEs*.
- (c) Other—please explain.

Please provide reasoning to support your choice of (a), (b) or (c).

**Responses from comment letters**

*Question G2*

114. Approximately 65% of comment letters responding to Question G2 support continuing the current programme for developing Q&As after this comprehensive review is completed (choice (a)). The following points cover the main reasons given:

- (a) The guidance in the Q&As is helpful. Issuing Q&As does not affect the stability of the standard or add an additional burden on preparers as the Q&As are non-mandatory. Additional guidance is particularly useful for smaller organisations and in jurisdictions that have limited accounting resources.
- (b) Even though the initial period of implementation is over, issues will continue to arise. Many jurisdictions are still in the early stages of adopting the *IFRS for SMEs*, or haven't adopted it yet, and so implementation issues may arise in those jurisdictions. Furthermore, if significant changes are made to the *IFRS for SMEs* during this comprehensive review, additional implementation issues may arise on application of the new requirements.
- (c) If application issues arise for which non-mandatory guidance would be useful, Q&As should be developed. There have only been a few Q&As issued so far and demand is likely to reduce in the future. Consequently, the Q&A programme will not result in excessive guidance being issued.
- (d) Issues are likely to become more complex in the future and non-mandatory guidance will be useful to address these issues.
- (e) So far Q&As have provided guidance on considerations when applying judgement, rather than creating rules.

115. Approximately 25% of comment letters responding to Question G2 believe the current Q&A programme has served its purpose and should not be continued (choice (b)). The following points cover the main reasons given:

- (a) The *IFRS for SMEs* should be the only source of guidance for SMEs. The initiative to provide non-mandatory guidance is inconsistent with objective of a single stable standalone standard. New issues can be addressed by future updates of the *IFRS for SMEs* or in training material.

- (b) There is a risk that Q&As crystallise rules that over time make the *IFRS for SMEs* more prescriptive. The standard's straight forward principles based approach should not be compromised.
- (c) The Q&A programme is no longer necessary as it mainly deals with implementation questions arising in the early years.

116. Suggestions to improve the Q&A process include:

- (a) The current due process for the Q&As is not adequate. They do not go through as rigorous a due process as amendments to the *IFRS for SMEs* (in the triennial reviews). Although Q&As are non-mandatory, in practice documents issued from any part of the IASB are taken to be authoritative guidance. Some may regard Q&As as interpretations.
- (b) A large number of Q&As is not in keeping with the IASB's plan for periodic updating of the *IFRS for SMEs* and requires extra work for SMEs and users of their financial statements to keep up to date with guidance issued. The SMEIG should follow the criteria set out in their Terms of Reference more closely—ie issues should be urgent, widespread and likely to result in significant divergence in practice. Issues not meeting this criteria should be addressed in next update rather than in a Q&A.
- (c) The Q&As must not address issues that also relate to full IFRSs. These issues must be subject to the IASB's full due process and issued by the IFRS Interpretations Committee. There is a danger the Q&As may be applied in the interpretation of full IFRSs.
- (d) Many SMEs do not have professional accounting staff to prepare financial statements. The SMEIG should have a process where it can respond to more minor issues and provide guidance in an informal way outside the Q&A process. It could also consider publishing the most useful responses, eg in a newsletter. The mechanism of the Q&A process is excessively time-consuming, inflexible and formal as the only process for responding to issues.

- (e) In paragraph 19 of the SMEIG Terms of Reference it states that the IASB will establish a procedure via its website for interested parties to refer questions to the SMEIG. This process should be set up.
- (f) Constituents should be allowed to submit a comment letter on the Q&As confidentially. Furthermore the response period should be increased to a minimum of 60 days to allow non-English speakers and organisations coordinating a response based on feedback from their members sufficient time to respond.

### Question G3

117. Approximately 50% of comment letters responding to Question G3 think the guidance in the seven final Q&As should be considered for inclusion during this update of the *IFRS for SMEs*, or incorporated in other supporting material (eg Basis for Conclusions), as suggested in Question G3, and then deleted (choice (a)). The following points cover the main reasons given:
- (a) Incorporation of the Q&As as proposed in Question G3 would keep the *IFRS for SMEs* standalone and comprehensive. It is less burdensome for SMEs if all guidance is in one place.
  - (b) None of the Q&As change requirements in the *IFRS for SMEs* so there would be no adverse consequences of incorporating them.
  - (c) Mandatory guidance is more useful than non-mandatory guidance.
  - (d) The Q&As clarify requirements in areas where requirements are unclear or there was diversity in practice so they should be incorporated.
  - (e) Consistent with our view that the Q&A programme should cease, there should not be any parallel non-mandatory guidance on the *IFRS for SMEs*. All Q&As should be incorporated into the *IFRS for SMEs* or the training material and deleted.
118. Approximately 25% of comment letters responding to Question G3 believe the seven final Q&As should be retained as separate guidance (choice (b)). The following points cover the main reasons given.

- (a) Q&As should be retained separately to ensure the *IFRS for SMEs* is kept as straightforward and principles-based as possible.
- (b) The Q&As are interpretations of matters that are not that complex. So it is not necessary to incorporate them in the *IFRS for SMEs*.
- (c) If Q&As are incorporated in the *IFRS for SMEs* as application guidance, future Q&As will be considered by constituents as being de facto authoritative (at least until the next review of the *IFRS for SMEs*).

119. Approximately 25% of comment letters responding to Question G3 had other suggestions for how to deal with the seven Q&As. The following points cover the main suggestions given:

- (a) A number of the Q&As are very detailed and they should be tailored appropriately before they are incorporated to avoid adding excessive guidance in the *IFRS for SMEs*. Too much detail would not fit the overall balance of the *IFRS for SMEs* and would undermine its principles-based nature. On the other hand, a small amount of additional clarification may be needed in some areas.
- (b) Care is required when incorporating Q&As not to create any unintended new financial reporting requirements.
- (c) Incorporate in the *IFRS for SMEs*, those Q&As that clarify its requirements. Keep the other Q&As as separate guidance.
- (d) All Q&As should be incorporated in training material, not the *IFRS for SMEs*.

120. A few comment letters provided suggestions of which Q&As should be incorporated in the *IFRS for SMEs*, which should be incorporated in the Basis for Conclusions or training material, and which should be simply deleted. Staff have considered these suggestions individually when developing their recommendation below.



**Staff comments**

121. Paragraphs 15-17 and 19-36 of the SMEIG *Terms of Reference and Operating Procedures* (Terms of Reference) set out the criteria for deciding whether SMEIG should address an issue in a Q&A and the due process in developing a Q&A:

**Criteria for Q&As**

- 15 In deciding whether to address an issue in a Q&A, the SMEIG shall consider the following criteria:
- (a) The issue should be pervasive, ie it has arisen or is likely to arise in financial reporting by a broad group of SMEs in various jurisdictions.
  - (b) Owing to a lack of clarity in the *IFRS for SMEs*, unintended or inconsistent implementation has occurred or is likely to occur in the absence of a Q&A.
  - (c) The SMEIG can reach a consensus on the appropriate treatment on a timely basis.
- 16 The SMEIG is expected to focus on a limited number of pervasive issues and not to seek to create an extensive rule-oriented environment. Nor does the SMEIG act as an urgent issues group.
- 17 The SMEIG should not reach a consensus in a Q&A that changes or conflicts with the *IFRS for SMEs*. If the SMEIG concludes that the requirements of the *IFRS for SMEs* should be amended, the SMEIG should make a recommendation in that regard to the IASB in connection with the IASB's periodic review of the *IFRS for SMEs*.

**Due process in developing a Q&A***Stage 1 Identification of issues*

- 19 Preparers, auditors and others with an interest in financial reporting by SMEs will be encouraged to refer to the SMEIG questions about the application of the *IFRS for SMEs*. The IASB will establish a procedure for doing so via its website (and possibly by email as well).

*Stage 2 Deciding whether to publish a Q&A*

- 20 Staff will prepare a brief analysis of each submitted question with a recommendation on:
- (a) whether it should be addressed by a Q&A (based on the criteria in paragraphs 15–17 above), and
  - (b) if the recommendation is to develop a Q&A, what the staff's recommended answer would be and why.
- 21 Staff will send their recommendations to members of the SMEIG by email. SMEIG members will have 30 days to respond on (a) whether the SMEIG member agrees with the staff recommendation on the need for a Q&A, and (b) if the recommendation is to publish a Q&A, whether the SMEIG member agrees with the substance of the staff's proposed answer and, if not, what the SMEIG member's answer would be and why. SMEIG members should respond in writing to the staff. Such correspondence will be made available to all SMEIG

members and to members of the IASB. It will be treated as internal correspondence rather than as public documents.

*Stage 3 Reaching a tentative consensus*

- 22 Staff will prepare a summary of the views of SMEIG members.
- (a) A tentative consensus is reached on the need for a Q&A if a simple majority of SMEIG members agree with the staff recommendation.
  - (b) A tentative consensus is reached on the substance of the staff's proposed answer for a Q&A if a simple majority of SMEIG members agree with the staff recommendation.

- 23 If a tentative consensus is reached that a Q&A is needed and on the substance of the answer, staff shall prepare a draft Q&A. The draft Q&A will include the SMEIG's reasons for reaching the answer that it did.

*Stage 4 The IASB's role in the draft Q&A*

- 24 Members of the IASB will have access to all of the communications within the SMEIG leading to development of the draft Q&A.
- 25 The draft Q&A will be circulated to the members of the IASB by email. The draft Q&A is released for public comment unless four or more IASB members object within a week of being informed of its completion.

*Stage 5 Inviting comments on the tentative consensus*

- 26 The draft Q&A will be posted on the IASB's website for public comment for a period of 30 days. The website will include a procedure for submitting comments electronically. Comments will be posted on the IASB's website.
- 27 Staff will prepare an analysis of comments received. Staff will make recommendations for changes to the draft Q&A, if any, and send them to SMEIG members with a request for approval of a final Q&A. SMEIG members should respond in writing to the staff within 30 days. Such correspondence will be made available to all SMEIG members and to members of the IASB. It will be treated as internal correspondence rather than as public documents.

*Stage 6 Reaching a final consensus*

- 28 Staff will prepare a summary of the views of SMEIG members. A consensus is reached on the final Q&A if a simple majority of SMEIG members agree with the staff recommendation.

*Stage 7 The IASB's role in the release of a final Q&A*

- 29 Members of the IASB will have access to all of the communications within the SMEIG leading to development of the final Q&A, and to the public comments on a draft Q&A.
- 30 When the SMEIG has reached a consensus on a final Q&A, it will be circulated to members of the IASB by email.
- (a) If four or more IASB members object .....(omitted to save space)
  - (b) If no more than three IASB members object to the consensus within 15 days of being informed of its completion, the Q&A will be published.
- 31 Approved Q&As are informal guidance and not mandatory standards. Therefore, they are published in the name of the SMEIG, not the IASB.

*Stage 7 Publication of a final Q&A*

- 32 SMEIG final Q&As will be posted on the IASB’s website, possibly in batches rather than one by one, and made available without charge. They will not be separately printed.
- 33 The IASB will create an email alert list by which interested parties can register to be kept informed about the *IFRS for SMEs*. Those who register will be notified of draft Q&As that have been posted on the IASB’s website for public comment, and of final Q&As that are published.
- 34 SMEIG decisions not to develop a Q&A will not be published.
- 35 SMEIG Q&As will include the SMEIG’s reasons for reaching the answer that it reached.
- 36 Correspondence among SMEIG members and IASB staff will not be made public.
122. Paragraph 26 of the SMEIG Terms of Reference currently states that “The draft Q&A will be posted on the IASB’s website for public comment for a period of 30 days.” When the first draft Q&A was issued in February 2011, many respondents said the comment period was too short. Since then comment periods for draft Q&As have typically been 2 months. This change will be incorporated in the SMEIG Terms of Reference next time it is updated.
123. The following are the seven Q&As issued by the SMIEG:

Q&A number/ title	Guidance
<b>2012/04</b> Recycling of cumulative exchange differences on disposal of a subsidiary	Clarifies that the cumulative exchange differences that arise on translation of a foreign subsidiary into the group presentation currency for consolidation purposes are prohibited from being recognised in profit or loss on disposal of the subsidiary.
<b>2012/03</b> Fallback to IFRS 9 <i>Financial Instruments</i>	Clarifies that the option of applying the recognition and measurement provisions for financial instruments in full IFRSs instead of Sections 11 and 12 of the <i>IFRS for SMEs</i> refers exclusively to IAS 39. SMEs are not permitted to apply IFRS 9.
<b>2012/02</b> Jurisdiction requires fallback to full IFRSs	Addresses the situation where a jurisdiction requires entities applying the <i>IFRS for SMEs</i> to fallback to full IFRSs when transactions are not specifically covered by the <i>IFRS for SMEs</i> . The Q&A clarifies an entity can only assert compliance with the <i>IFRS for SMEs</i> if applying full IFRSs requirements does not conflict with paragraphs 10.4-10.6 of the <i>IFRS for SMEs</i> .
<b>2012/01</b> Application of ‘undue cost or effort’	Provides guidance on how to interpret ‘undue cost or effort’ and how it differs from the defined term ‘impracticable’.

<b>2011/03</b> Interpretation of ‘traded in a public market’	Provides guidance on what constitutes a ‘public market’ and also guidance on how to determine when something is ‘traded’ on a public market.
<b>2011/02</b> Entities that typically have public accountability	Paragraph 1.3(b) of the <i>IFRS for SMEs</i> identifies certain entities that <u>typically</u> have public accountability, eg banks, credit unions etc. The Q&A clarifies that such entities should not automatically be assumed to have public accountability. The Q&A illustrates why the assumption might be wrong for captive insurance subsidiaries and investment funds with few participants.
<b>2011/01</b> Use of <i>IFRS for SMEs</i> in a parent’s separate financial statements	Clarifies a parent entity that itself does not have public accountability may present its separate financial statements in accordance with the <i>IFRS for SMEs</i> if it is part of a group that is required, or chooses, to present consolidated financial statements in accordance with full IFRSs.

### Staff recommendation

124. Most of the respondents who think the Q&A programme should cease are from developed countries where SMEs have access to better accounting resources. Many comment letters, including those covering developing countries, say Q&As are helpful to smaller companies and jurisdictions with limited accounting expertise. Based on this feedback, staff are of the view that the Q&A process fulfils a helpful educational process, and should be continued. Furthermore, staff suggest the IASB should establish a procedure for constituents to submit issues to SMEIG via its website (paragraph 19 of the SMEIG Terms of Reference).
125. Staff think the current due process for Q&As is appropriate for an interpretive function, but is excessive for an educational function. This contributes to the view of many respondents that the non-mandatory Q&As are similar to mandatory interpretations issued by the IFRS Interpretations Committee. In contrast, the IFRS Foundation training material provides guidance and illustrative examples on requirements in the *IFRS for SMEs*, including guidance on requirements in the IFRS for SMEs that are similar to those in full IFRSs. The training material is not subject to formal due process like Q&As, eg not subject to a formal approval process involving all IASB members (as explained in paragraphs 24, 25 and 29-31

of the SMEIG Terms of Reference). Consequently, it is perceived as educational, rather than interpreting the IFRS for SMEs.

126. Staff recommend that the approval process for Q&A's be similar to that for other educational material. In line with this, the staff would consult assigned IASB members when writing their recommendations for SMEIG review, but only the SMEIG would approve the Q&As. This would ensure Q&As are seen as non-mandatory educational guidance developed by the SMEIG, rather than interpretations issued under the approval of the IASB. It would also allow a bit more flexibility on the issues that the SMEIG addresses.
127. So far the SMEIG have only issued 7 Q&As. The staff do not expect that the suggested change in the due process will mean that the rate of issuing Q&As will increase. The staff do not think the SMEIG should respond to more minor issues and provide informal guidance. One of the primary aims of the training material issued by the IFRS Foundation was to provide this kind of guidance. If issues are too minor to become Q&As they can be considered for future updates of the IFRS Foundation training material.
128. Staff propose that Q&As are considered for incorporation in the *IFRS for SMEs* at each triennial review. All seven Q&As are currently being incorporated in the IFRS Foundation training material. Therefore the staff suggest that all Q&As are deleted during the comprehensive review process to maintain the standalone status of the *IFRS for SMEs*. Staff suggest the Q&As should be incorporated in the *IFRS for SMEs* as follows:

Q&A number and title	Staff's suggested treatment
<b>2012/04</b> Recycling of cumulative exchange differences on disposal of a subsidiary	Can easily be incorporated by modifying the wording in paragraph 9.18. Will also be included in the training material on Section 9 of the <i>IFRS for SMEs</i>
<b>2012/03</b> Fallback to IFRS 9 <i>Financial Instruments</i>	Dealt with in Issue 7 above
<b>2012/02</b> Jurisdiction requires fallback to full	Too detailed to incorporate. It will be included in the training material on Section 10 of the

IFRSs	<i>IFRS for SMEs</i>
<b>2012/01</b> Application of ‘undue cost or effort’	Dealt with in Issue A.13 of Agenda Paper 3. It will be included in the training material in the relevant sections of the <i>IFRS for SMEs</i>
<b>2011/03</b> Interpretation of ‘traded in a public market’	Too detailed to incorporate. It will be included in the training material on Section 1 of the <i>IFRS for SMEs</i>
<b>2011/02</b> Entities that typically have public accountability	Suggest clarifying in paragraph 1.3(b) that the entities listed are not automatically publicly accountable because there seems to be confusion about this based on responses to the RFI. Most of the detail in this Q&A is too complex to incorporate but will be included in the training material on Section 1 of the <i>IFRS for SMEs</i>
<b>2011/01</b> Use of <i>IFRS for SMEs</i> in a parent’s separate financial statements	Can easily be incorporated in paragraph 1.6 in a few words. Will also be included in the training material on Section 1 of the <i>IFRS for SMEs</i>

#### Question to the SMEIG

**12a) Should the Q&A programme continue after this comprehensive review is completed?**

**12b) If so, should any changes be made to the current SMEIG *Terms of Reference and Operating Procedures*?**

**12c) Should Q&As be incorporated into the *IFRS for SMEs*?**