

2009

International Accounting Standards Board (IASB®)

Basis for Conclusions

IFRS[®] for SMEs

International Financial Reporting Standard (IFRS[®])
for Small and Medium-sized Entities (SMEs)



**International Financial
Reporting Standard
for
Small and Medium-sized Entities
(IFRS for SMEs)**

Basis for Conclusions

This Basis for Conclusions accompanies the *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)* (see separate booklet) and is published by the International Accounting Standards Board (IASB), 30 Cannon Street, London EC4M 6XH, United Kingdom.

Tel: +44 (0)20 7246 6410

Fax: +44 (0)20 7246 6411

Email: iasb@iasb.org

Web: www.iasb.org

The International Accounting Standards Committee Foundation (IASCF), the authors and the publishers do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

The *IFRS for SMEs* and its accompanying documents are published in three parts:

ISBN for this part: 978-1-907026-18-8

ISBN for complete publication (three parts): 978-1-907026-16-4

Copyright © 2009 IASCF

All rights reserved. No part of this publication may be translated, reprinted or reproduced or utilised in any form either in whole or in part or by any electronic, mechanical or other means, now known or hereafter invented, including photocopying and recording, or in any information storage and retrieval system, without prior permission in writing from the IASCF.

International Financial Reporting Standards (including International Accounting Standards and SIC and IFRIC Interpretations), Exposure Drafts, and other IASB publications are copyright of the IASCF. The approved text of International Financial Reporting Standards and other IASB publications is that published by the IASB in the English language. Copies may be obtained from the IASCF. Please address publications and copyright matters to:

IASC Foundation Publications Department,
1st Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.

Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749

Email: publications@iasb.org Web: www.iasb.org



International
Accounting Standards
Board®

The IASB logo/the IASCF logo/‘Hexagon Device’, the IASC Foundation Education logo, ‘IASC Foundation’, ‘eIFRS’, ‘IAS’, ‘IASB’, ‘IASC’, ‘IASCF’, ‘IASs’, ‘IFRIC’, ‘IFRS’, ‘IFRSs’, ‘International Accounting Standards’, ‘International Financial Reporting Standards’ and ‘SIC’ are Trade Marks of the IASCF.

CONTENTS

paragraphs

**BASIS FOR CONCLUSIONS ON
INTERNATIONAL FINANCIAL REPORTING STANDARD FOR
SMALL AND MEDIUM-SIZED ENTITIES**

BACKGROUND	BC1–BC35
Discussion paper (June 2004)	BC5–BC7
Recognition and measurement questionnaire (April 2005) and public round tables (October 2005)	BC8–BC11
Board deliberations leading to the exposure draft	BC12–BC14
Exposure draft (February 2007)	BC15–BC19
Field tests	BC20–BC25
Responses to the exposure draft	BC26
Board redeliberations of the proposals in the exposure draft	BC27–BC31
Additional input to the Board	BC32
Special outreach	BC33
Final <i>IFRS for SMEs</i> : main changes from the exposure draft	BC34
This Basis for Conclusions	BC35
WHY GLOBAL FINANCIAL REPORTING STANDARDS FOR SMEs?	BC36–BC48
Should the IASB develop standards for SMEs?	BC38–BC43
Should others do it?	BC39
Do national standard-setters support an IASB initiative?	BC40–BC41
An <i>IFRS for SMEs</i> is consistent with the IASB's mission	BC42
Existing IFRSs include some differences for non-public entities	BC43
Different users' needs and cost-benefit considerations	BC44–BC47
Adoption of an <i>IFRS for SMEs</i> does not imply that full IFRSs are not appropriate for SMEs	BC48
THE OBJECTIVE OF THE <i>IFRS FOR SMEs</i>	BC49–BC54
Why determination of taxable income and determination of distributable income are not specific objectives of the <i>IFRS for SMEs</i>	BC49–BC52
Why it is not the purpose of the <i>IFRS for SMEs</i> to provide information to owner-managers to help them make management decisions	BC53–BC54
'PUBLIC ACCOUNTABILITY' AS THE PRINCIPLE FOR IDENTIFYING THE ENTITIES FOR WHICH THE <i>IFRS FOR SMEs</i> IS INTENDED AND THOSE FOR WHICH IT IS NOT INTENDED	BC55–BC77
Entities whose securities are traded in a public market have public accountability	BC58
Financial institutions have public accountability	BC59
SMEs that provide an essential public service	BC60–BC61
SMEs that are economically significant in their home jurisdiction	BC62–BC63
Approval by owners to use the <i>IFRS for SMEs</i>	BC64

SMEs that are a subsidiary, associate or joint venture of an IFRS investor	BC65–BC68
Quantified size criteria	BC69–BC70
Suitability of the <i>IFRS for SMEs</i> for very small entities—the ‘micros’	BC71–BC75
The <i>IFRS for SMEs</i> is not intended for small publicly-traded entities	BC76–BC77
‘SMALL AND MEDIUM-SIZED ENTITIES’	BC78–BC79
THE USERS OF SMEs’ FINANCIAL STATEMENTS PREPARED USING THE <i>IFRS FOR SMEs</i>	BC80
THE EXTENT TO WHICH THE <i>IFRS FOR SMEs</i> SHOULD BE A STAND-ALONE DOCUMENT	BC81–BC88
Accounting policy options	BC84–BC86
Omitted topics	BC87–BC88
WHETHER ALL ACCOUNTING POLICY OPTIONS IN FULL IFRSs SHOULD BE ALLOWED IN THE <i>IFRS FOR SMEs</i>	BC89–BC94
WHY THE FRAMEWORK AND PRINCIPLES AND MANDATORY GUIDANCE IN EXISTING IFRSs ARE THE APPROPRIATE STARTING POINT FOR DEVELOPING THE <i>IFRS FOR SMEs</i>	BC95–BC97
RECOGNITION AND MEASUREMENT SIMPLIFICATIONS	BC98–BC136
Financial instruments	BC99–BC107
Amortisation and impairment of goodwill and other indefinite-life intangible assets	BC108–BC112
Charge all development costs to expense	BC113–BC114
Cost method for associates and jointly controlled entities	BC115
Fair value through profit or loss for associates and jointly controlled entities with published price quotations	BC116–BC117
Non-current assets held for sale	BC118–BC119
Borrowing costs	BC120
Income tax	BC121–BC122
Exchange differences on monetary items	BC123
Less fair value for agriculture	BC124
Employee benefits—measurement of the defined benefit obligation	BC125
Employee benefits—actuarial gains and losses of defined benefit plans	BC126–BC127
Employee benefits—unvested past service cost of defined benefit plans	BC128
Share-based payment	BC129–BC131
Transition to the <i>IFRS for SMEs</i>	BC132
Investment property	BC133
Government grants	BC134
Exception from straight-line method by lessees for operating leases when payments compensate the lessor for inflation	BC135
No annual review of useful life, residual value and depreciation/amortisation method	BC136
SIMPLIFICATIONS CONSIDERED BUT NOT ADOPTED	BC137–BC150
Not to require a cash flow statement	BC138–BC139

Treat all leases as operating leases	BC140
Treat all employee benefit plans as defined contribution plans	BC141
Completed contract method for construction contracts	BC142
Fewer provisions	BC143
Non-recognition of share-based payment	BC144
Non-recognition of deferred taxes	BC145
Cost model for all agriculture	BC146
No consolidated financial statements	BC147
Recognition of all items of income and expense in profit or loss	BC148–BC150
ISSUES ADDRESSED IN THE <i>IFRS FOR SMEs</i> THAT ARE NOT COVERED IN FULL IFRSs	BC151
OPTIONAL REVERSION TO FULL IFRSs BY AN ENTITY USING THE <i>IFRS FOR SMEs</i>	BC152–BC154
PRESENTATION SIMPLIFICATIONS	BC155
DISCLOSURE SIMPLIFICATIONS	BC156–BC158
WHY A SEPARATE VOLUME RATHER THAN ADDED SECTIONS IN EACH IFRS	BC159–BC161
WHY ORGANISATION BY TOPIC	BC162
THE BOARD'S PLAN FOR MAINTAINING (UPDATING) THE <i>IFRS FOR SMEs</i>	BC163–BC165
DISSENTING OPINION	

Basis for Conclusions on International Financial Reporting Standard for Small and Medium-sized Entities

This Basis for Conclusions accompanies, but is not part of, the IFRS.

Background

- BC1 In its transition report of December 2000 to the newly formed International Accounting Standards Board (IASB), the outgoing Board of the International Accounting Standards Committee said ‘A demand exists for a special version of International Accounting Standards for Small Enterprises.’
- BC2 Shortly after its inception in 2001, the IASB began a project to develop accounting standards suitable for small and medium-sized entities (SMEs). The Board set up a working group of experts to provide advice on the issues and alternatives and potential solutions.
- BC3 In their 2002 annual report, the Trustees of the IASC Foundation, under which the IASB operates, wrote ‘The Trustees also support efforts by the IASB to examine issues particular to emerging economies and to small and medium-sized entities.’ In July 2005 the Trustees formalised their support by restating the objectives of the Foundation and the IASB as set out in the Foundation’s Constitution. They added an objective that, in developing IFRSs, the IASB should take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies. Similarly, the Standards Advisory Council has consistently encouraged the IASB to pursue the project.
- BC4 At public meetings during the second half of 2003 and early 2004, the Board developed some preliminary and tentative views about the basic approach that it would follow in developing accounting standards for SMEs. It tested that approach by applying it to several IFRSs.

Discussion paper (June 2004)

- BC5 In June 2004 the Board published a discussion paper *Preliminary Views on Accounting Standards for Small and Medium-sized Entities* setting out and inviting comments on the Board’s approach. This was the first discussion paper that the IASB published. The Board received 120 responses.
- BC6 The major issues set out in the discussion paper were:
- (a) Should the IASB develop special financial reporting standards for SMEs?
 - (b) What should be the objectives of a set of financial reporting standards for SMEs?
 - (c) For which entities would IASB standards for SMEs be intended?
 - (d) If IASB standards for SMEs do not address a particular accounting recognition or measurement issue confronting an entity, how should that entity resolve the issue?

- (e) May an entity using IASB standards for SMEs elect to follow a treatment permitted in an IFRS that differs from the treatment in the related IASB standard for SMEs?
- (f) How should the Board approach the development of IASB standards for SMEs? To what extent should the foundation of SME standards be the concepts and principles and related mandatory guidance in IFRSs?
- (g) If IASB standards for SMEs are built on the concepts and principles and related mandatory guidance in full IFRSs, what should be the basis for modifying those concepts and principles for SMEs?
- (h) In what format should IASB standards for SMEs be published?

BC7 At its meetings later in 2004, the Board considered the issues raised by respondents to the discussion paper. In December 2004 and January 2005, the Board made some tentative decisions on the appropriate way forward for the project. The responses to the discussion paper showed a clear demand for an *International Financial Reporting Standard for SMEs (IFRS for SMEs)* and a preference, in many countries, to adopt the *IFRS for SMEs* rather than locally or regionally developed standards. The Board therefore decided to publish an exposure draft of an *IFRS for SMEs* as the next step.

Recognition and measurement questionnaire (April 2005) and public round tables (October 2005)

BC8 Most respondents to the discussion paper said that simplifications of the principles for recognising and measuring assets, liabilities, income and expenses were needed, but few specifics were proposed. And when some specifics were proposed, the commentators generally did not indicate the particular transactions or other events or conditions that create the recognition or measurement problem for SMEs under IFRSs or how that problem might be solved.

BC9 The IASB concluded that it needed further information to assess possible recognition and measurement simplifications. Consequently the Board decided to hold public round-table meetings with preparers and users of the financial statements of SMEs to discuss possible modifications of the recognition and measurement principles in IFRSs for use in an *IFRS for SMEs*. The Board instructed the staff to develop and publish a questionnaire as a tool to identify issues that should be discussed at those round-table meetings.

BC10 The questionnaire, published April 2005, asked two questions:

- 1 What are the areas for possible simplification of recognition and measurement principles for SMEs?
- 2 From your experience, please indicate which topics addressed in IFRSs might be omitted from SME standards because they are unlikely to occur in an SME context. If they occur, the standards would require the SME to determine its appropriate accounting policy by looking to the applicable IFRSs.

BC11 The Board received 101 responses to the questionnaire. Those responses were discussed with the Standards Advisory Council (June 2005), with the SME Working Group (June 2005), World Standard-Setters (September 2005) and at the public round tables held by the Board in October 2005. A total of 43 groups participated in the round-table discussions with the Board over a two-day period.

Board deliberations leading to the exposure draft

BC12 The IASB's working group met in June 2005 and made a comprehensive set of recommendations to the Board regarding the recognition, measurement, presentation and disclosure requirements that should be included in an exposure draft of an *IFRS for SMEs*. Later in 2005, the Board considered those recommendations and the views expressed in the responses to the discussion paper and the questionnaire, and at the round tables. During those deliberations, the Board made tentative decisions about the requirements to be included in the exposure draft.

BC13 On the basis of those tentative decisions, at the Board meeting in January 2006 the staff presented a preliminary draft of the exposure draft. The working group met in late January 2006 to review that draft and prepared a report of its recommendations for the Board's consideration. The Board's discussion of the draft began in February 2006 and continued throughout the remainder of 2006. Revised drafts of the exposure draft were prepared for each Board meeting from May onwards. From July 2003 until the exposure draft was published in February 2007, the issues were deliberated by the Board at 31 public Board meetings.

BC14 To keep constituents informed and help them begin planning their responses, a complete staff draft of the exposure draft was posted on the IASB's website in August 2006. A revised staff draft was posted on the IASB's website in November 2006.

Exposure draft (February 2007)

BC15 In February 2007 the IASB published for public comment an exposure draft of a proposed *IFRS for SMEs*. The aim of the proposed standard was to provide a simplified, self-contained set of accounting principles that are appropriate for smaller, non-listed entities and are based on full IFRSs, which are developed to meet the needs of entities whose securities trade in public capital markets.

BC16 The proposed standard was based on full IFRSs with modifications to reflect the needs of users of SMEs' financial statements and cost-benefit considerations. The exposure draft proposed five types of simplifications of full IFRSs:

- (a) some topics in IFRSs were not included because they are not relevant to typical SMEs. However, for some of those omitted topics, the exposure draft proposed that if SMEs encountered circumstances or a transaction that is addressed in full IFRSs but not in the *IFRS for SMEs*, then they would be required to follow the relevant full IFRS.
- (b) where an IFRS allows an accounting policy choice, the exposure draft included only the simpler option but proposed that SMEs should be permitted to choose the more complex option by reverting to the relevant full IFRS.

- (c) simplification of many of the principles for recognising and measuring assets, liabilities, income, and expenses that are in full IFRSs.
- (d) substantially fewer disclosures.
- (e) simplified redrafting.

Primarily because of (a) and (b) above, the proposed *IFRS for SMEs* would not be a stand-alone document.

- BC17 Along with the exposure draft, the IASB published and invited comment on proposed implementation guidance consisting of a complete set of illustrative financial statements and a disclosure checklist. The exposure draft was accompanied by a basis for conclusions that explained the Board's reasoning in reaching the conclusions in the exposure draft.
- BC18 The exposure draft was translated into five languages (a first for the IASB), and the translations were posted on the IASB's website. The IASB also published a staff summary of the exposure draft to help constituents get an initial understanding of the proposals, also posted on the IASB's website.
- BC19 Comments on the exposure draft were initially due on 30 September 2007, but the Board extended the deadline to 30 November 2007 primarily at the request of field test participants.

Field tests

- BC20 With the help of national standard-setters and others, the IASB completed a field test programme that involved 116 small entities from 20 countries. About 35 per cent had ten or fewer full-time employees. A further 35 per cent of the entities in the sample had between 11 and 50 full-time employees. Over half of the entities had bank loans or significant overdrafts. A third had foreign operations.
- BC21 The goals of the field testing were:
- (a) to assess understandability of the exposure draft by identifying any parts that field testers found hard to understand.
 - (b) to assess appropriateness of the scope of topics covered by identifying transactions, events or conditions that the field tester encountered but that were not covered in the draft *IFRS for SMEs*, and to find out how the field tester made its accounting policy decision, including whether it looked to full IFRSs as a reference.
 - (c) to assess the burden of applying the draft *IFRS for SMEs*, for instance, whether information required to apply it was not available or available only with undue cost or effort.
 - (d) to assess the impact of the proposals by identifying the nature and degree of changes from the field tester's current GAAP or current reporting practices.
 - (e) to assess accounting policy choices made by the field testers, and why, where the exposure draft would allow choices.

- (f) to assess any special problems in applying the draft *IFRS for SMEs* that arose for field testers that are so-called ‘micro entities’ (those with fewer than ten employees) and for field testers in developing economies.
 - (g) to assess the adequacy of implementation guidance by identifying where additional guidance would be helpful to the field tester.
- BC22 To help the field testers and others in applying the exposure draft, the IASB published a compliance checklist for the exposure draft that was developed by one of the international accounting firms.
- BC23 The field test questionnaire was posted on the IASB’s website in June 2007 in English, French and Spanish. Field test entities were asked:
- (a) to provide background information about their business and reporting requirements.
 - (b) to submit their most recent annual financial statements under their existing accounting framework.
 - (c) to restate those financial statements in accordance with the exposure draft for the same financial year (without prior year information).
 - (d) to respond to a series of questions designed to identify specific problems encountered in applying the exposure draft.
- BC24 A report of the field tests was provided to Board members and posted on the IASB’s website. The main factor influencing the type of problems identified by field testers was the nature and extent of differences between the *IFRS for SMEs* and an entity’s existing accounting framework.
- BC25 About half of the field test entities identified no, or only one or two, issues or problems. The three main issues identified by field testers were the following:
- (a) **Annual remeasurements.** Many field testers highlighted the need to perform annual remeasurements of fair values for financial assets and liabilities and residual values for property, plant and equipment as problematic because market prices or active markets were often not available.
 - (b) **Disclosures.** A significant number of field test entities noted problems due to the nature, volume and complexity of disclosures. Many felt that some of the disclosures required them to provide sensitive information, for example key management personnel compensation when there are only one or two key management personnel.
 - (c) **Reference to full IFRSs.** Around 20 per cent of the field testers chose to refer back to full IFRSs to apply an option available by cross-reference. Most of those entities already followed full IFRSs or a national GAAP similar to full IFRSs. A few field testers said that they would have wanted to use one of the options but did not do so because of the need to refer back to full IFRSs. Only a small number of entities specifically noted that they needed to refer back to full IFRSs to understand or clarify requirements in the exposure draft.

Responses to the exposure draft

BC26 The Board received 162 letters of comment on the exposure draft. All letters were made available to Board members and posted on the IASB's website. Paragraphs BC36–BC158 discuss the Board's reasoning on the chief technical issues in the project. Here is a brief summary of the main issues raised in the letters of comment on the exposure draft:

- (a) **Stand-alone.** The single most pervasive comment was to make the *IFRS for SMEs* a fully stand-alone document, or nearly so. Over 60 per cent of the respondents would eliminate all cross-references to full IFRSs. Virtually all of the remaining respondents either (i) would keep the number of cross-references to an absolute minimum or (ii) were indifferent between having minimal cross-references and removing all of them. The exposure draft had included 23 cross-references to full IFRSs.
- (b) **Accounting policy options.** Whether the *IFRS for SMEs* should allow SMEs to use all of the accounting policy options that are available in full IFRSs was discussed by many commentators. This issue is interrelated with making the *IFRS for SMEs* a stand-alone document without cross-references to full IFRSs.
- (c) **Anticipating changes to IFRSs.** Many respondents were of the view that the *IFRS for SMEs* should be based on existing IFRSs and should not anticipate changes to IFRSs that the Board is considering in current agenda projects.
- (d) **Disclosures.** Many comment letters encouraged the Board to make further simplifications to disclosure requirements, but many of those letters did not identify specific disclosures to be eliminated or why.
- (e) **Scope.** Many comment letters discussed the suitability of the exposure draft for micro-sized entities (those with fewer than ten or so employees), small listed entities, and entities that act in a fiduciary capacity.
- (f) **Fair value measurements.** Many respondents proposed that fair value measurements in the *IFRS for SMEs* should be restricted to (a) circumstances in which a market price is quoted or readily determinable without undue cost or effort and (b) all derivatives. Some respondents also thought it was necessary that the measured item should be readily realisable or that there should be an intention to dispose or transfer.
- (g) **Implementation guidance.** Many respondents cited the need for implementation guidance and encouraged the Board to consider how such guidance could be provided.
- (h) **Comments on specific sections of the exposure draft.** In addition to general issues, most comment letters raised issues related to specific sections in the exposure draft. While respondents offered suggestions for each of the 38 sections of the exposure draft, staff noted that the topics that attracted the most comments (generally in favour of further simplifications) included:
 - (i) consolidation.
 - (ii) amortisation of goodwill and other indefinite life intangibles.

- (iii) financial instruments.
- (iv) requirements for statements of cash flows and changes in equity.
- (v) measurements for impairments.
- (vi) measurements for finance leases.
- (vii) share-based payment.
- (viii) employee benefits.
- (ix) income taxes.

Board redeliberations of the proposals in the exposure draft

- BC27 The Board began its redeliberations of the proposals in the exposure draft in March 2008. Those redeliberations continued until April 2009—a total of 13 public Board meetings—bringing to 44 the total number of public meetings at which the Board deliberated the *IFRS for SMEs*.
- BC28 At the Board’s meeting in March 2008, staff presented an overview of the main issues (other than disclosure issues) raised in the comment letters on the exposure draft (see paragraph BC26). At the Board’s next meeting in April 2008, staff presented an overview of the main issues that were identified as a result of the programme for field testing the exposure draft (see paragraph BC25). Both of those meetings were educational in nature, and the staff did not raise any issues for decision.
- BC29 The IASB’s working group met on 10 and 11 April 2008. The recommendations of working group members on each issue (other than disclosure) that was discussed at that meeting were presented to the Board at the Board’s meeting in May 2008. Recommendations of working group members relating to disclosure were presented to the Board in an agenda paper at the Board’s meeting in July 2008. The reports of the working group’s recommendations were posted on the IASB’s website.
- BC30 In May 2008, the Board began to redeliberate the proposals in the exposure draft by addressing issues relating to scope, recognition, measurement and presentation that were raised in the letters of comment on the exposure draft, in the reports prepared by field test entities and in the recommendations of the working group. Those redeliberations continued until February 2009. A list of the main changes made as a result of those redeliberations is presented in paragraph BC34.
- BC31 In March 2009 the Board considered the changes made during its redeliberations of the exposure draft in the light of the guidelines for re-exposure in the *Due Process Handbook for the IASB*. The Board concluded that the changes made did not warrant re-exposure.

Additional input to the Board

- BC32 The project was discussed with the Standards Advisory Council at seven of its meetings. The issues in the project were also discussed at five of the annual meetings of the World Accounting Standard-Setters hosted by the IASB from 2003 to 2008. The working group met four times to discuss the issues and provide advice to the Board. A joint working party of the European Financial Reporting Advisory Group (EFRAG) and the European Federation of Accountants (FEE) was particularly helpful in providing guidance to the staff.

Special outreach

- BC33 The Board recognised that, typically, SMEs and their auditors and bankers have not participated in the IASB's due process. With the objectives of encouraging such parties to become familiar with the IASB and to consider and respond to the exposure draft, the staff undertook a comprehensive outreach programme on this project. That programme entailed presentations at 104 conferences and round tables in 40 countries, including 55 presentations after the exposure draft was published. The IASB also explained the exposure draft and responded to questions in two public webcasts for which nearly 1,000 participants registered. In April 2007 a staff overview of the exposure draft, in question-and-answer format, was posted on the IASB's website. The purpose of the overview was to provide an introduction to the proposals in non-technical language.

Final IFRS for SMEs: main changes from the exposure draft

- BC34 The main changes from the recognition, measurement and presentation principles proposed in the exposure draft that resulted from the Board's redeliberations were:
- (a) making the final IFRS a stand-alone document (eliminating all but one of the 23 cross-references to full IFRSs that had been proposed in the exposure draft, with the one remaining cross-reference providing an option, but not a requirement, to follow IAS 39 *Financial Instruments: Recognition and Measurement* instead of the two financial instruments sections of the *IFRS for SMEs*).
 - (b) eliminating most of the complex options and adding guidance on the remaining ones (thereby removing the cross-references to full IFRSs proposed in the exposure draft).
 - (c) omitting topics that typical SMEs are not likely to encounter (thereby removing the cross-references to full IFRSs proposed in the exposure draft).
 - (d) not anticipating possible future changes to IFRSs.
 - (e) eliminating reference to the pronouncements of other standard-setting bodies as a source of guidance when the *IFRS for SMEs* does not address an accounting issue directly.
 - (f) conforming to the presentation requirements of IAS 1 *Presentation of Financial Statements*, except for its requirement to present a statement of financial position at the beginning of the earliest comparative period.

- (g) allowing different accounting policies to be used to account for different types of investments in separate financial statements, rather than one policy for all types of investment.
- (h) restructuring of Section 11 *Financial Assets and Financial Liabilities* of the exposure draft into two sections (Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*) and clarifying that amortised cost is applied to nearly all the basic financial instruments held or issued by SMEs.
- (i) amending the requirements for assessing impairment of an equity instrument carried at cost when fair value cannot be measured reliably.
- (j) eliminating proportionate consolidation as an option for investments in jointly controlled entities.
- (k) removing the distinction between distributions from pre-acquisition and post-acquisition profits for investments accounted for by the cost method and, instead, recognising all dividends received in profit or loss.
- (l) eliminating the requirement, when applying the equity method, of a maximum three-month difference between the reporting date of the associate or jointly controlled entity and that of the investor.
- (m) requiring an entity to choose its accounting policy for investment property on the basis of circumstances, rather than as a free choice option. Investment property whose fair value can be measured reliably without undue cost or effort will be measured at fair value through profit or loss. All other investment property will be accounted for as property, plant and equipment using a cost-depreciation-impairment model.
- (n) not requiring an annual review of residual value, useful life and depreciation method of property, plant and equipment and intangible assets.
- (o) not permitting a revaluation option for property, plant and equipment
- (p) not permitting a revaluation option for intangibles.
- (q) amortising all indefinite life intangibles, including goodwill.
- (r) recognising as expenses all research and development costs.
- (s) incorporating 'present value of minimum lease payments' into the measurement of a finance lease.
- (t) allowing other than the straight-line method by lessees for operating leases when the minimum lease payments are structured to compensate the lessor for expected general inflation.
- (u) incorporating into the *IFRS for SMEs* the February 2008 'puttables' amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1.

- (v) requiring all government grants to be accounted for using a single, simplified model: recognition in income when the performance conditions are met (or earlier if there are no performance conditions) and measurement at the fair value of the asset received or receivable.
- (w) recognising as expenses all borrowing costs.
- (x) adding further simplifications for share-based payments, including directors' valuations, rather than the intrinsic value method.
- (y) allowing subsidiaries to measure employee benefit and share-based payment expense on the basis of a reasonable allocation of the group charge.
- (z) adding value-in-use measurement for asset impairments.
- (aa) introducing the notion of cash-generating unit for testing asset impairments.
- (bb) simplifying the guidance for calculating impairment of goodwill.
- (cc) simplifying the measurement of a defined benefit pension obligation if a 'projected unit credit' measurement is not available and would require undue cost or effort.
- (dd) permitting recognition of actuarial gains and losses in other comprehensive income as an alternative to recognition in profit or loss (while retaining the proposal in the exposure draft to prohibit deferral of actuarial gains and losses).
- (ee) on disposal of a foreign operation, not 'recycling' through profit or loss any cumulative exchange differences that were recognised previously in other comprehensive income.
- (ff) eliminating the held-for-sale classification and related special measurement requirements.
- (gg) incorporating all the IFRS 1 *First-time Adoption of International Financial Reporting Standards* exemptions into Section 35 *Transition to the IFRS* for SMEs.
- (hh) incorporating the conclusions of the following Interpretations, which address transactions and circumstances that SMEs often encounter:
 - (i) IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*.
 - (ii) IFRIC 4 *Determining Whether an Arrangement Contains a Lease*.
 - (iii) IFRIC 8 *Scope of IFRS 2*.
 - (iv) IFRIC 12 *Service Concession Arrangements*.
 - (v) IFRIC 13 *Customer Loyalty Programmes*.
 - (vi) IFRIC 15 *Agreements for the Construction of Real Estate*.
 - (vii) IFRIC 17 *Distributions of Non-cash Assets to Owners*.
 - (viii) SIC-12 *Consolidation—Special Purpose Entities*.

This Basis for Conclusions

BC35 This Basis for Conclusions sets out the main issues addressed by the Board, the alternatives considered, and the Board's reasons for accepting some alternatives and rejecting others.

Why global financial reporting standards for SMEs?

BC36 Global financial reporting standards, applied consistently, enhance the comparability of financial information. Accounting differences can obscure the comparisons that investors, lenders and others make. By resulting in the presentation of high quality comparable financial information, high quality global financial reporting standards improve the efficiency of allocation and the pricing of capital. This benefits not only those who provide debt or equity capital but also those entities that seek capital because it reduces their compliance costs and removes uncertainties that affect their cost of capital. Global standards also improve consistency in audit quality and facilitate education and training.

BC37 The benefits of global financial reporting standards are not limited to entities whose securities are traded in public capital markets. In the Board's judgement, SMEs—and those who use their financial statements—can benefit from a common set of accounting standards. SMEs' financial statements that are comparable from one country to the next are needed for the following reasons:

- (a) Financial institutions make loans across borders and operate multinationally. In most jurisdictions, over half of all SMEs, including the very small ones, have bank loans. Bankers rely on financial statements in making lending decisions and in establishing terms and interest rates.
- (b) Vendors want to evaluate the financial health of buyers in other countries before they sell goods or services on credit.
- (c) Credit rating agencies try to develop ratings uniformly across borders. Similarly, banks and other institutions that operate across borders often develop ratings in a manner similar to credit rating agencies. Reported financial information is crucial to the rating process.
- (d) Many SMEs have overseas suppliers and use a supplier's financial statements to assess the prospects of a viable long-term business relationship.
- (e) Venture capital firms provide funding to SMEs across borders.
- (f) Many SMEs have outside investors who are not involved in the day-to-day management of the entity. Global accounting standards for general purpose financial statements and the resulting comparability are especially important when those outside investors are located in a different jurisdiction from the entity and when they have interests in other SMEs.

Should the IASB develop standards for SMEs?

BC38 In deciding to develop an *IFRS for SMEs*, the IASB was mindful of the following issues:

- (a) Should financial reporting standards for SMEs be developed by others?
- (b) Do national standard-setters support the IASB developing an *IFRS for SMEs*?
- (c) Is developing an *IFRS for SMEs* consistent with the Board's mission?
- (d) Existing IFRSs make some distinctions for SMEs.

Should others do it?

BC39 The Board considered whether financial reporting standards for SMEs would best be developed by others—either globally, country by country, or perhaps at a regional level—while the IASB focused its efforts primarily on standards for entities that participate in public capital markets. However, the Board noted that its mission, as set out in the IASB Foundation's Constitution (see paragraph BC42), is not restricted to standards for entities that participate in public capital markets. Focusing only on those entities is likely to result in standards or practices for other entities (which are over 99 per cent of all entities in virtually all jurisdictions) that may not address the needs of external users of financial statements, are not consistent with the IASB's *Framework for the Preparation and Presentation of Financial Statements* or standards, may lack comparability across national boundaries or within a country, and may not allow for an easy transition to full IFRSs for entities that wish to enter the public capital markets. For those reasons, the Board decided to undertake the project.

Do national standard-setters support an IASB initiative?

BC40 National accounting standard-setters throughout the world support the IASB's initiative. In September 2003 the IASB hosted a meeting of the world's national accounting standard-setters. In preparation for that meeting the Board surveyed them about standards for SMEs. With near unanimity, the standard-setters that responded said that the IASB should develop global standards for SMEs.

BC41 The Board discussed the progress on its project on standards for SMEs at subsequent annual meetings of the world's national accounting standard-setters in 2005–2008. Standard-setters continued to support the Board's project.

An *IFRS for SMEs* is consistent with the IASB's mission

BC42 Developing a set of standards for SMEs is consistent with the IASB's mission. The principal objective of the IASB, as set out in the Constitution and in the *Preface to International Financial Reporting Standards*, is 'to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions'. 'Single set' means that all entities in similar circumstances globally should follow the same standards. The circumstances of SMEs can be different from those of larger, publicly accountable entities in several ways, including:

- (a) the users of the entity's financial statements and their information needs;
- (b) how the financial statements are used by those users;

- (c) the depth and breadth of accounting expertise available to the entity; and
- (d) SMEs' ability to bear the costs of following the same standards as the larger, publicly accountable entities.

Existing IFRSs include some differences for non-public entities

BC43 IFRSs include several differences for entities whose securities are not publicly traded. For example:

- (a) IFRS 8 *Operating Segments* requires disclosure of segment information only by entities whose debt or equity instruments are traded or registered for trading in a public market.
- (b) IAS 27 *Consolidated and Separate Financial Statements* exempts some parent entities from preparing consolidated financial statements if (i) the parent itself is a subsidiary of an IFRS parent and (ii) its debt or equity instruments are not traded in a public market. Similar exemptions are in IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.
- (c) IAS 33 *Earnings per Share* requires presentation of earnings per share data only by entities whose ordinary shares or potential ordinary shares are publicly traded.

Different users' needs and cost-benefit considerations

BC44 The *Framework* (paragraph 12) states:

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

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

BC45 Users of financial statements of SMEs may have less interest in some information in general purpose financial statements prepared in accordance with full IFRSs than users of financial statements of entities whose securities are registered for trading in public securities markets or that otherwise have public accountability. For example, users of financial statements of SMEs may have greater interest in short-term cash flows, liquidity, balance sheet strength and interest coverage, and in the historical trends of profit or loss and interest coverage, than they do in information that is intended to assist in making forecasts of an entity's long-term cash flows, profit or loss, and value. However, users of financial statements of SMEs may need some information that is not ordinarily presented in the financial statements of listed entities. For example, as an alternative to the public capital markets, SMEs often obtain capital from shareholders, directors and suppliers, and shareholders and directors often pledge personal assets so that the SMEs can obtain bank financing.

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.

- BC47 The Board faced a dilemma in deciding whether to develop an *IFRS for SMEs*. On the one hand, it believed that the same concepts of financial reporting are appropriate for all entities regardless of public accountability—particularly the concepts for recognising and measuring assets, liabilities, income and expenses. This suggested that a single set of accounting standards should be suitable for all entities, although it would not rule out disclosure differences based on users' needs and cost-benefit considerations. On the other hand, the Board acknowledged that differences in the types and needs of users of SMEs' financial statements, as well as limitations in, and the cost of, the accounting expertise available to SMEs, suggested that a separate standard for SMEs is appropriate. That separate standard could include constraints such as consistent definitions of elements of financial statements and focus on the needs of users of financial statements of SMEs. On balance, the Board concluded that the latter approach (separate standard) was appropriate.

Adoption of an *IFRS for SMEs* does not imply that full IFRSs are not appropriate for SMEs

- BC48 The Board believes that the objective of financial statements as set out in the *Framework* is appropriate for SMEs as well as for entities required to apply full IFRSs. The objective of providing information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions is applicable without regard to the size of the reporting entity. Therefore, standards for general purpose financial statements of entities with public accountability would result in financial statements that meet the needs of users of financial statements of all entities, including those without public accountability. The Board is aware of research that shows that over 80 jurisdictions currently require or permit SMEs to use full IFRSs.

The objective of the *IFRS for SMEs*

Why determination of taxable income and determination of distributable income are not specific objectives of the *IFRS for SMEs*

- BC49 IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities. General purpose financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. General purpose financial statements are intended to meet the needs of users that are not in a position to demand reports tailored to their particular information needs. General purpose financial statements provide information about an entity's financial position, performance and cash flows.

- BC50 Determining taxable income requires special purpose financial statements—ones designed to comply with the tax laws and regulations in a particular jurisdiction. Similarly, an entity’s distributable income is defined by the laws and regulations of the country or other jurisdiction in which it is domiciled.
- BC51 Tax authorities are also often important external users of the financial statements of SMEs. Almost invariably, tax authorities have the power to demand whatever information they need to meet their statutory tax assessment and collection obligations. Tax authorities often look to financial statements as the starting point for determining taxable profit, and some have policies to minimise the adjustments to accounting profit or loss for the purpose of determining taxable profit. Nonetheless, global accounting standards for SMEs cannot deal with tax reporting in individual jurisdictions. But profit or loss determined in conformity with the *IFRS for SMEs* can serve as the starting point for determining taxable profit in a given jurisdiction by means of a reconciliation that is easily developed at a national level.
- BC52 A similar reconciliation can be developed to adjust profit or loss as measured by the *IFRS for SMEs* to distributable income under national laws or regulations.

Why it is not the purpose of the *IFRS for SMEs* to provide information to owner-managers to help them make management decisions

- BC53 Owner-managers use SMEs’ financial statements for many purposes. However, it is not the purpose of the *IFRS for SMEs* to provide information to owner-managers to help them make management decisions. Managers can obtain whatever information they need to run their business. (The same is true for full IFRSs.) Nonetheless, general purpose financial statements will often also serve managers’ needs by providing insights into the business’s financial position, performance and cash flows.
- BC54 SMEs often produce financial statements only for the use of owner-managers, or for tax reporting or other non-securities regulatory filing purposes. Financial statements produced solely for those purposes are not necessarily general purpose financial statements.

‘Public accountability’ as the principle for identifying the entities for which the *IFRS for SMEs* is intended and those for which it is not intended

- BC55 One of the first issues confronting the Board was to describe the class of entities for which the *IFRS for SMEs* would be intended. The Board recognised that, ultimately, decisions on which entities should use the *IFRS for SMEs* will rest with national regulatory authorities and standard-setters. However, a clear definition of the class of entity for which the *IFRS for SMEs* is intended is essential so that:
- (a) the Board can decide on the standard that is appropriate for that class of entity, and

- (b) national regulatory authorities, standard-setters, reporting entities and their auditors will be informed of the intended scope of applicability of the *IFRS for SMEs*.

In that way, jurisdictions will understand that there are some types of entities for which the *IFRS for SMEs* is not intended.

- BC56 In the Board’s judgement, the *IFRS for SMEs* is appropriate for an entity that does not have public accountability. An entity has public accountability (and therefore should use full IFRSs) if:
- (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), 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.
- BC57 While the two criteria for entities with public accountability stated in the preceding paragraph did not change significantly from those proposed in the exposure draft, the Board did make several small changes in response to comments received:
- (a) The exposure draft referred to, but did not define, public markets. The *IFRS for SMEs* includes a definition consistent with the definition in IFRS 8.
 - (b) The exposure draft had proposed that any entity that holds assets in a fiduciary capacity for a broad group of outsiders should not be eligible to use the *IFRS for SMEs*. Respondents noted that entities often hold assets in a fiduciary capacity for reasons incidental to their primary business (as, for example, may be the case for travel or real estate agents, schools, charitable organisations, co-operative enterprises and utility companies). The *IFRS for SMEs* clarifies that those circumstances do not result in an entity having public accountability.

Entities whose securities are traded in a public market have public accountability

- BC58 Public securities markets, by their nature, bring together entities that seek capital and investors who are not involved in managing the entity and who are considering whether to provide capital, and at what price. Although those public investors often provide longer-term risk capital, they do not have the power to demand the financial information they might find useful for investment decision-making. They must rely on general purpose financial statements. An entity’s decision to enter a public capital market makes it publicly accountable—and it must provide the outside debt and equity investors with a broader range of financial information than may be needed by users of financial statements of entities that obtain capital only from private sources. Governments

recognise this public accountability by establishing laws, regulations and regulatory agencies that deal with market regulation and disclosures to investors in public securities markets. The Board concluded that, regardless of size, entities whose securities are traded in a public market should follow full IFRSs.

Financial institutions have public accountability

- BC59 Similarly, a primary business of banks, insurance companies, securities brokers/dealers, pension funds, mutual funds and investment banks is to hold and manage financial resources entrusted to them by a broad group of clients, customers or members who are not involved in the management of the entities. Because such an entity acts in a public fiduciary capacity, it is publicly accountable. In most cases, these institutions are regulated by laws and government agencies.

SMEs that provide an essential public service

- BC60 In the discussion paper, the Board's tentative view was that, in addition to the two conditions cited in paragraph BC56, an entity also has public accountability if it is a public utility or similar entity that provides an essential public service.
- BC61 Most respondents to the discussion paper, and also the working group, pointed out that in many jurisdictions entities that provide public services can be very small—for example, refuse collection companies, water companies, local power generating or distribution companies, and local cable television companies. Respondents argued that the nature of the users of the financial statements, rather than the nature of the business activity, should determine whether full IFRSs should be required. The Board concurred.

SMEs that are economically significant in their home jurisdiction

- BC62 In the discussion paper, the Board's tentative view was that, in addition to the two conditions cited in paragraph BC56, an entity also has public accountability if it is economically significant in its home country on the basis of criteria such as total assets, total income, number of employees, degree of market dominance and nature and extent of external borrowings.
- BC63 Most respondents, and the working group, argued that economic significance does not automatically result in public accountability. Public accountability, as that term is used in paragraphs 1.2 and 1.3, refers to accountability to those present and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs. The Board concluded that economic significance may be more relevant to matters of political and societal accountability. Whether such accountability requires general purpose financial statements using full IFRSs is a matter best left to local jurisdictions to decide.

Approval by owners to use the *IFRS for SMEs*

- BC64 In the discussion paper, the Board's tentative view was that 100 per cent of the owners of a small or medium-sized entity must agree before the entity could use the *IFRS for SMEs*. The objection of even one owner of an entity to the use of the *IFRS for SMEs* would be sufficient evidence of the need for that entity to prepare its financial statements on the basis of full IFRSs. Most respondents did not agree. In their view, an objection, or even a non-response, by one or a few shareholders does not make an entity publicly accountable. They thought that the two criteria of (a) publicly traded and (b) financial institution appropriately identify entities with public accountability. The Board found those arguments persuasive.

SMEs that are a subsidiary, associate or joint venture of an IFRS investor

- BC65 In the discussion paper, the Board's tentative view was that if a subsidiary, joint venture or associate of an entity with public accountability prepares financial information in accordance with full IFRSs to meet the requirements of the parent, venturer or investor, it should be required to comply with full IFRSs, not the *IFRS for SMEs*, in its separate financial statements. In the Board's view, because the information in accordance with full IFRSs had been produced for other purposes, it would be more costly to prepare a second set of financial statements that comply with the *IFRS for SMEs*. Most respondents to the discussion paper did not agree. Many said that the IFRS data produced for consolidation or equity accounting purposes have a different materiality threshold from that necessary for the investee's own financial statements. Moreover, they said that the circumstances of the entity, rather than the circumstances of its parent or investor, should determine whether it has public accountability. Consequently, they argued, it would be costly and burdensome for the investee to have to apply full IFRSs in its own financial statements. The Board found those arguments persuasive. Therefore, SMEs should assess their eligibility to use the *IFRS for SMEs* on the basis of their own circumstances, even if they also submit financial information in accordance with full IFRSs to a parent, venturer or investor.
- BC66 Some respondents to the exposure draft proposed that a subsidiary whose parent uses full IFRSs, or is part of a consolidated group that uses full IFRSs, should be permitted to make the simplified disclosures required by the *IFRS for SMEs* but should be required to follow the accounting recognition and measurement principles in full IFRSs that are used by its parent if they are different from the accounting recognition and measurement principles in the *IFRS for SMEs*. Those holding this view thought that allowing the subsidiary to use the same recognition and measurement principles as its parent or its group would make consolidation easier.
- BC67 The Board concluded, however, that the result would be, in effect, optional fallbacks to full IFRSs for a relatively small subset of entities eligible to use the *IFRS for SMEs*. The result would also be a hybrid set of accounting standards that is neither full IFRSs nor the *IFRS for SMEs*. That set of standards would differ for each such small or medium-sized entity depending on the accounting policies chosen by its parent or its group. The *IFRS for SMEs* is a standard appropriate for non-publicly accountable entities, not a 'pick and choose' set of options.

A subsidiary of a full IFRS entity can always choose to follow full IFRSs in its separate statements. The Board concluded that if an entity's financial statements are described as conforming to the *IFRS for SMEs*, it must comply with all of the provisions of that IFRS.

BC68 Because the *IFRS for SMEs* allows accounting policy choices for some recognition and measurement principles, differences from full IFRSs can be minimised by an entity's accounting policy choices. The circumstances in which the *IFRS for SMEs* would mandate a recognition or measurement principle that is different from measurement under full IFRSs are limited. The following are the principal examples:

- (a) Non-current assets (or groups of assets and liabilities) held for sale
 - *IFRS for SMEs*: Holding assets for sale triggers an assessment for impairment, but otherwise no special 'held-for-sale' classification or special accounting requirements.
 - *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*: Measured at lower of carrying amount and fair value less costs to sell. Depreciation stops when classified as held for sale.
- (b) Unvested past service cost of defined benefit pension plans
 - *IFRS for SMEs*: Recognised in profit or loss immediately.
 - *IAS 19 Employee Benefits*: Recognised as an expense on a straight-line basis over the average period until the benefits become vested.
- (c) Exchange differences on a monetary item that forms part of the net investment in a foreign operation, in consolidated financial statements
 - *IFRS for SMEs*: Recognise in other comprehensive income and do not reclassify in profit or loss on disposal of the investment.
 - *IAS 21 The Effects of Changes in Foreign Exchange Rates*: Reclassify in profit or loss on disposal of the investment.
- (d) Borrowing costs
 - *IFRS for SMEs*: Must be charged to expense.
 - *IAS 23 Borrowing Costs*: Costs directly attributable to the acquisition, construction or production of a qualifying asset must be capitalised.
- (e) Investment in an associate for which there is a published price quotation
 - *IFRS for SMEs*: Must be measured at fair value through profit or loss.
 - *IAS 28 Investments in Associates*: Must be measured using the equity method.
- (f) Investment in a jointly controlled entity for which there is a published price quotation
 - *IFRS for SMEs*: Must be measured at fair value through profit or loss.
 - *IAS 31 Interests in Joint Ventures*: Must be measured using the equity method or proportionate consolidation.

- (g) Investment property whose fair value can be measured reliably without undue cost or effort
- *IFRS for SMEs*: Must be measured at fair value through profit or loss.
 - IAS 40 *Investment Property*: Accounting policy choice of fair value through profit or loss or cost-depreciation-impairment model.
- (h) Biological assets
- *IFRS for SMEs*: Measure at fair value through profit or loss only if fair value is readily determinable without undue cost or effort.
 - IAS 41 *Agriculture*: Presumption that fair value can be reliably measured.
- (i) Income tax
- *IFRS for SMEs*: Where a different tax rate applies to distributed income, initially measure current and deferred taxes at the rate applicable to undistributed profits.
 - Exposure draft *Income Tax*: In such a case, initially measure current and deferred taxes at the tax rate expected to apply when the profits are distributed.
- (j) Share-based payments with cash alternatives in which the terms of the arrangement provide the counterparty with a choice of settlement
- *IFRS for SMEs*: Account for the transaction as a cash-settled share-based payment transaction unless either the entity has a past practice of settling by issuing equity instruments or the option to settle in cash has no commercial substance.
 - IFRS 2 *Share-based Payment*: Accounting akin to a compound instrument.

Quantified size criteria

- BC69 The definition of SMEs does not include quantified size criteria for determining what is a small or medium-sized entity. The Board noted that its standards are used in over 100 countries. The Board concluded that it is not feasible to develop quantified size tests that would be applicable and long-lasting in all of those countries. This is consistent with the Board's general principle-based approach to standard-setting.
- BC70 In deciding which entities should be required or permitted to use the *IFRS for SMEs*, jurisdictions may choose to prescribe quantified size criteria. Similarly, a jurisdiction may decide that entities that are economically significant in that country should be required to use full IFRSs rather than the *IFRS for SMEs*.

Suitability of the *IFRS for SMEs* for very small entities—the 'micros'

- BC71 Some contend that it is unrealistic to design a single standard that could be used by all entities that do not have public accountability, because the size range of this group of entities is simply too broad—from very large unlisted entities with

hundreds or even several thousand employees down to ‘micro-sized’ entities with fewer than ten employees. The Board did not agree. The *IFRS for SMEs* is designed for entities, regardless of size, that are required, or elect, to publish general purpose financial statements for external users. External users such as lenders, vendors, customers, rating agencies and employees need specific types of information but are not in a position to demand reports tailored to meet their particular information needs. They must rely on general purpose financial statements. This is as true for ‘micros’ as it is for larger SMEs. Financial statements prepared using the *IFRS for SMEs* are intended to meet those needs.

- BC72 Some who question whether the *IFRS for SMEs* will be suitable for micros argue that many micro entities prepare financial statements solely to submit to income tax authorities for the purpose of determining taxable income. As explained more fully in paragraphs BC50–BC52, determining taxable income (and also determining legally distributable income) requires special purpose financial statements—ones designed to comply with tax and other laws and regulations in a particular jurisdiction.
- BC73 Moreover, the Board noted that, in many countries, full IFRSs are required for all or most limited liability companies, including the micros. The Board also noted that many other countries permit the micros to use full IFRSs. As mentioned in paragraph BC48, over 80 jurisdictions have decided that full IFRSs should be required or permitted for all or most entities, including micros. If full IFRSs have been judged suitable for all entities, then the *IFRS for SMEs* will surely not be burdensome. The guidance in the *IFRS for SMEs* is clear and concise. That guidance may cover some transactions or circumstances that micro SMEs do not typically encounter, but the Board did not believe that this imposes a burden on micro SMEs. The topical organisation of the *IFRS for SMEs* will make it easy for micro SMEs to identify those aspects of the standard that are relevant to their circumstances.
- BC74 Some favour a very simple and brief set of accounting requirements for micro SMEs—with broad principles of accrual basis accounting (some even suggest a cash basis or modified cash basis), specific recognition and measurement principles for only the most basic transactions, and requiring perhaps only a balance sheet and an income statement with limited note disclosures. The Board acknowledged that this approach might result in relatively low costs to SMEs in preparing financial statements. However, the Board concluded that the resulting statements would not meet the objective of decision-usefulness because they would omit information about the entity’s financial position, performance and changes in financial position that is useful to a wide range of users in making economic decisions. Moreover, the Board believed that financial statements prepared using such a simple and brief set of accounting requirements might not serve SMEs by improving their ability to obtain capital. Therefore, the Board concluded that it should not develop this type of *IFRS for SMEs*.
- BC75 The IASB does not have the power to require any entity to use its standards. That is the responsibility of legislators and regulators. In some countries, the government has delegated that power to a separately established independent standard-setter or to the professional accountancy body. They will have to decide

which entities should be required or permitted to use, or perhaps prohibited from using, the *IFRS for SMEs*. The Board believes that the *IFRS for SMEs* will be suitable for all entities that do not have public accountability, including micros.

The *IFRS for SMEs* is not intended for small publicly traded entities

- BC76 Entities, large or small, whose debt or equity instruments are traded in public capital markets have chosen to seek capital from outside investors who are not involved in managing the business and who do not have the power to demand information that they might find useful. Full IFRSs have been designed to serve public capital markets by providing financial information especially intended for investors and creditors in such markets. Some of the principles in full IFRSs for recognising and measuring assets, liabilities, income and expense have been simplified in the *IFRS for SMEs*. Some of the disclosures required by full IFRSs are not required by the *IFRS for SMEs*. The Board concluded, therefore, that full IFRSs are appropriate for an entity with public accountability.
- BC77 A jurisdiction that believes that the *IFRS for SMEs* is appropriate for small publicly traded entities in that jurisdiction could incorporate the requirements of the *IFRS for SMEs* into its national standards for small publicly traded entities. In that case, however, the financial statements would be described as conforming to national GAAP. The *IFRS for SMEs* prohibits them from being described as conforming to the *IFRS for SMEs*.

‘Small and medium-sized entities’

- BC78 ‘Small and medium-sized entities’ (SMEs) as used by the IASB is defined in Section 1 of the *IFRS for SMEs*. The term is widely recognised and used around the world, although many jurisdictions have developed their own definitions of the term for a broad range of purposes including prescribing financial reporting obligations. Often those national or regional definitions include quantitative criteria based on revenue, assets, employees or other factors. Frequently, the term is used to mean or to include very small entities without regard to whether they publish general purpose financial statements for external users.
- BC79 The IASB considered whether to use another term. Even before publishing the exposure draft in February 2007, the Board had used the term ‘non-publicly accountable entity’ (NPAE) for several months during 2005. During its redeliberations of the proposals in the exposure draft during 2008, the Board also used both NPAE and ‘private entities’ for several months.
- (a) **Non-publicly accountable entities.** Because the Board concluded that full IFRSs are necessary for entities with public accountability, the terms ‘publicly accountable entity’ and ‘non-publicly accountable entity’ had some appeal. However, constituents argued that this term is not widely recognised, whereas ‘small and medium-sized entities’ and the acronym ‘SMEs’ are universally recognised. Also, some said that ‘non-publicly accountable entities’ seemed to imply, incorrectly, that the smaller entities were not publicly accountable for anything. Furthermore, the objectives of the IASC Foundation and the IASB as set out in the Foundation’s Constitution use the term ‘small and medium-sized entities’:

The objectives of the IASC Foundation are:

- (a) to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;
 - (b) to promote the use and rigorous application of those standards;
 - (c) in fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies; and
 - (d) to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions.
- (b) **Private entities.** The term 'private entities' is commonly used in some jurisdictions—most particularly in North America—to refer to the kinds of entities that meet the IASB's definition of SMEs (entities without public accountability). In other jurisdictions, however—most particularly those in which government ownership of equity interests in business entities is common—the term 'private entities' is used much more restrictively to refer only to those entities in which there is no government ownership. In such jurisdictions, the term 'private entities' would be likely to be misunderstood.

For these reasons, the Board decided to use 'small and medium-sized entities'.

The users of SMEs' financial statements prepared using the *IFRS for SMEs*

- BC80 The *IFRS for SMEs* is intended for non-publicly accountable entities that publish general purpose financial statements for external users. The main groups of external users include:
- (a) banks that make loans to SMEs.
 - (b) vendors that sell to SMEs and use SMEs' financial statements to make credit and pricing decisions.
 - (c) credit rating agencies and others that use SMEs' financial statements to rate SMEs.
 - (d) customers of SMEs that use SMEs' financial statements to decide whether to do business.
 - (e) SMEs' shareholders that are not also managers of their SMEs.

The extent to which the *IFRS for SMEs* should be a stand-alone document

- BC81 In developing the exposure draft of the proposed *IFRS for SMEs*, the Board intended it to be a stand-alone document for many typical small entities. However, it was not proposed to be fully stand-alone. The exposure draft proposed that there

should be two types of occasions when the *IFRS for SMEs* would require entities to look to full IFRSs:

- (a) The exposure draft proposed that when IFRSs provide an accounting policy option, SMEs should have the same option. The simpler option would be included in the *IFRS for SMEs* while the other option or options would be permitted by cross-reference to IFRSs.
- (b) The exposure draft proposed that the *IFRS for SMEs* should omit some accounting topics that are addressed in full IFRSs, because the Board believed that typical SMEs are not likely to encounter such transactions or circumstances. However, the exposure draft proposed cross-references requiring SMEs that encounter such a transaction or circumstances to look to a particular IFRS or to a part of one.

BC82 Over 60 per cent of the comment letters that addressed the ‘stand-alone’ issue would eliminate all cross-references to full IFRSs. Another 35 per cent either (a) would keep the number of cross-references to an absolute minimum or (b) were indifferent between having minimal cross-references and removing all cross-references. Also, the working group members recommended that the *IFRS for SMEs* should be a completely stand-alone document. The principal reasons put forward by those recommending a stand-alone IFRS were:

- (a) A stand-alone document would be more understandable and easier to use. It would also be perceived as a more user-friendly document and hence improve acceptance by jurisdictions considering adoption and by entities within the scope. Cross-references require SMEs to be familiar with both the *IFRS for SMEs* and full IFRSs—a requirement some viewed as even more burdensome than for an entity following full IFRSs.
- (b) The exposure draft had proposed that if an entity is required or permitted to follow an IFRS by cross-reference, the entity must apply that IFRS (or part of that IFRS) in full. The twin criteria of user needs and cost-benefits on which the Board based its decisions in the *IFRS for SMEs* were not applied to the cross-referenced material. However, if such cross-referenced topics were incorporated within the *IFRS for SMEs*, it would be possible to make appropriate simplifications of recognition and measurement principles and/or reduce disclosures based on the user needs and cost-benefit criteria adopted by the Board.
- (c) Cross-references cause ‘version control’ issues. For example, if a cross-referenced IAS or IFRS or Interpretation is amended or replaced, should that result in an ‘automatic’ change to the cross-reference? Or does the cross-reference to the earlier version of the IAS or IFRS or Interpretation remain? If there is an automatic change then this will cause more frequent updates to the *IFRS for SMEs* than every three years as planned by the Board. Also it would require SMEs applying cross-references to be aware of all changes to full IFRSs. If the cross-reference to the earlier version of the pronouncement remains, there may be confusion about which version of the Standard should be applied, especially because some cross-referenced paragraphs themselves, either directly or indirectly, refer to paragraphs of other full IFRSs (see (d) below). Also, the accounting chosen or required by cross-reference will not be comparable with that applied by full IFRS

entities. Additionally, if changes to full IFRSs are *de facto* amendments to the *IFRS for SMEs*, SMEs would need to participate in the due process that led to the changes in each IFRS—a burden SMEs generally told the Board they cannot handle (in responses to both the June 2004 discussion paper and the exposure draft).

- (d) There is a question of where the cross-references end. Some cross-referenced paragraphs, either directly or indirectly, refer to other paragraphs within full IFRSs. This is problematic because updates are made to full IFRSs, so SMEs would need to continuously monitor full IFRSs in case any changes might affect them via the cross-reference.

BC83 After considering the points raised by respondents to the exposure draft, the Board changed its view. The *IFRS for SMEs* does not have any mandatory requirement to look to full IFRSs.

Accounting policy 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.

BC85 The *IFRS for SMEs* does include one option for an entity to choose to follow a full IFRS, and that is the option to use IAS 39 *Financial Instruments: Recognition and Measurement* instead of Section 11 and Section 12. Otherwise, the final *IFRS for SMEs* is completely stand-alone—an entity applying it is not required to look to full IFRSs in addition to the *IFRS for SMEs*.

BC86 The exposure draft also proposed that if the standard does not address a transaction or other event or condition or provide a cross-reference back to another IFRS, an entity should select an accounting policy that results in relevant and reliable information. In making that judgement, an entity should consider, first, the requirements and guidance in the *IFRS for SMEs* dealing with similar and related issues and, second, the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles* of the draft standard. If that does not provide guidance, the entity may look to the requirements and guidance in IFRSs, including Interpretations of IFRSs, dealing with similar and related issues. This guidance remains in the *IFRS for SMEs*.

Omitted topics

BC87 In addition to the complex options, the second type of mandatory cross-reference to full IFRSs proposed in the exposure draft related to topics addressed in full IFRSs but omitted from the *IFRS for SMEs* because they were not expected to be relevant for the majority of SMEs. To make the final *IFRS for SMEs* a stand-alone document, the Board decided to incorporate into the final *IFRS for SMEs* the following topics for which the exposure draft had proposed a cross-reference to full IFRSs:

- (a) **Equity-settled share-based payment.** Addressed in Section 26 *Share-based Payment*.
- (b) **Share-based payment transactions with cash alternatives.** Addressed in Section 26.
- (c) **Fair value measurement of biological assets.** Addressed in Section 34 *Specialised Activities*.
- (d) **Hyperinflation.** Addressed in Section 31 *Hyperinflation*.
- (e) **Lessor accounting for finance leases.** Addressed in Section 20 *Leases*.
- (f) **The direct method of presenting operating cash flows.** Addressed in Section 7 *Statement of Cash Flows*.

- BC88 Furthermore, the Board decided that the *IFRS for SMEs* should not address the following topics for which the exposure draft had proposed a cross-reference to full IFRSs:
- (a) Earnings per share.
 - (b) Interim financial reporting.
 - (c) Segment reporting.
 - (d) Special accounting for assets held for sale.

Whether all accounting policy options in full IFRSs should be allowed in the *IFRS for SMEs*

- 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.

Why the *Framework* and principles and mandatory guidance in existing IFRSs are the appropriate starting point for developing the *IFRS for SMEs*

- BC95 The *IFRS for SMEs* was developed by:
- (a) extracting the fundamental concepts from the *Framework* and the principles and related mandatory guidance from IFRSs (including Interpretations), and
 - (b) considering the modifications that are appropriate in the light of users' needs and cost-benefit considerations.
- BC96 The Board judged that this approach is appropriate because the needs of users of financial statements of SMEs are similar in many ways to the needs of users of financial statements of publicly accountable entities. Therefore, full IFRSs are the logical starting point for developing an *IFRS for SMEs*.
- BC97 The Board rejected the alternative 'fresh start' approach because that approach could have resulted in different objectives of financial reports, different qualitative characteristics of financial information, different definitions of the elements of financial statements, and different concepts of recognition and measurement. The Board concluded that a 'fresh start' approach would be costly and time-consuming and ultimately futile. This is because, in the Board's view, there is sufficient convergence of users' needs relative to the general purpose financial statements of entities with and without public accountability.

Recognition and measurement simplifications

BC98 Paragraphs BC99–BC136 explain the significant simplifications to the recognition and measurement principles in full IFRSs that are reflected in the *IFRS for SMEs*, and the reasons for them. The Board also deliberated other recognition and measurement simplifications but decided not to adopt them (see paragraphs BC137–BC150).

Financial instruments

BC99 Many commentators said that the requirements of IAS 39 are burdensome for SMEs. They cited as especially burdensome for SMEs the complexities of classifying financial instruments into four categories, the ‘pass-through’ and ‘continuing involvement’ tests for derecognition, and the detailed calculations required to qualify for hedge accounting. The Board agreed that simplifications of IAS 39 are appropriate for SMEs.

BC100 Much of the complexity in IAS 39 results from permitting entities to choose from a range of classification alternatives and measurement attributes for financial instruments. Those choices reduce comparability and impose measurement complexity. The *IFRS for SMEs* enhances comparability and reduces complexity by limiting the classification categories, specifying a measurement attribute and limiting the use of other optional measurement attributes.

BC101 Principal among the simplifications proposed in the *IFRS for SMEs* are the following:

- (a) **Classification of financial instruments.** Financial instruments that meet specified criteria are measured at cost or amortised cost, and all others are measured at fair value through profit or loss. The available-for-sale and held-to-maturity classifications in IAS 39 are not available, thereby reducing the complexities associated with the two additional categories, including assessment of intentions and accounting ‘penalties’ in some cases.
- (b) **Derecognition.** The *IFRS for SMEs* establishes a simple principle for derecognition. That principle does not rely on the ‘pass-through’ and ‘continuing involvement’ provisions that apply to derecognition under IAS 39. Those provisions are complex and relate to derecognition transactions in which SMEs are typically not engaged.
- (c) **Hedge accounting.** The *IFRS for SMEs* focuses on the types of hedging that SMEs are likely to do, specifically hedges of:
 - (i) interest rate risk of a debt instrument measured at amortised cost.
 - (ii) foreign exchange risk or interest rate risk in a firm commitment or a highly probable forecast transaction.
 - (iii) price risk of a commodity that it holds or in a firm commitment or a highly probable forecast transaction to purchase or sell a transaction.
 - (iv) foreign exchange risk in a net investment in a foreign operation.

- (d) **Derivative financial instruments.** The *IFRS for SMEs* does not require separate accounting for ‘embedded derivatives’. However, non-financial contracts that include an embedded derivative with economic characteristics not closely related to the host contract are accounted for in their entirety at fair value (see paragraph BC105).
- BC102 With regard to hedge accounting, Section 12 requires periodic recognition and measurement of hedge ineffectiveness, but under less strict conditions than those in IAS 39. In particular, ineffectiveness is recognised and measured at the end of the financial reporting period, and hedge accounting is discontinued prospectively starting from that point, for hedges that no longer meet the conditions for hedge accounting. IAS 39 would require discontinuation of hedge accounting prospectively starting at the date the conditions were no longer met—a requirement that SMEs often say they find burdensome.
- BC103 As an alternative to simplified effectiveness testing, the Board considered an approach that is in the US standard SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* (Sections 815(20)(25)(102) to 815(20)(25)(117) of the FASB Codification) and is called the ‘shortcut method’. Under such a method, the *IFRS for SMEs* would impose strict conditions on the designation of a hedging relationship with subsequent hedge effectiveness assumed without need for measuring ineffectiveness. The Board concluded that simplified effectiveness testing is preferable to the shortcut method for two principal reasons:
- (a) Recognition of all hedge ineffectiveness in profit or loss is a basic principle of IAS 39. The shortcut method is inconsistent with that principle.
 - (b) To be able to assume that the possibility of hedge ineffectiveness is nil or insignificant, the key features of the hedging instrument and the hedged item, including the term, would have to match, and there could be no conditional terms. Consequently, hedge accounting would be prohibited if the hedging instrument is prepayable or puttable or has other early termination or extension features. Such a requirement would, in effect, make hedge accounting a practical impossibility for many, and perhaps most, SMEs.
- BC104 Section 12 also differs from IAS 39 with respect to hedge accounting in the following ways:
- (a) Hedge accounting cannot be achieved by using debt instruments (‘cash instruments’) as hedging instruments. IAS 39 permits this for a hedge of a foreign currency risk.
 - (b) Hedge accounting is not permitted with an option-based hedging strategy. Because hedging with options involves incurring a cost, SMEs are more likely to use forward contracts as hedging instruments than options.
 - (c) Hedge accounting for portfolios is not permitted. Hedging portfolios adds considerable accounting complexity because of the need to remeasure all of the hedged items individually at fair value to ensure that the appropriate amounts are derecognised when the instrument is sold and to ensure that the amortisation is appropriate when an instrument is no longer being hedged.

The simplification in (a) is appropriate since hedge accounting would not have a significant effect on the financial statements because of the offsetting effects of the accounting for a foreign currency debt instrument under Section 11 and the recognition of exchange differences on most monetary items in profit or loss under Section 30 *Foreign Currency Translation*. In addition, the Board does not believe that the simplifications in (b) and (c) will affect SMEs adversely because these are not hedging strategies that are typical of SMEs.

- BC105 Contracts to buy, sell, lease or insure a non-financial item such as a commodity, inventory, property, plant or equipment are accounted for as financial instruments within the scope of Section 12 if they could result in a loss to the buyer, seller, lessor, lessee or insured party as a result of contractual terms that are unrelated to changes in the price of the non-financial item, changes in foreign exchange rates, or a default by one of the counterparties. Such contracts are accounted for as financial instruments because their terms include a financial risk component that alters the settlement amount of the contract that is unrelated to the purchase or sale of, or leasing or insuring, the non-financial item.
- 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.

BC107 The exposure draft had proposed that an entity electing to follow IAS 39 instead of the financial instruments sections of the *IFRS for SMEs* would also have to comply in full with the disclosure requirements of IFRS 7 *Financial Instruments: Disclosures*. Many respondents to the exposure draft argued that many of the IFRS 7 disclosures are designed for financial institutions (which are ineligible to use the *IFRS for SMEs*) or for entities whose securities are traded in public capital markets. In their view, the financial instruments disclosures in the *IFRS for SMEs* are appropriate for all SMEs including those that choose to look to IAS 39 for recognition and measurement. The Board found this argument persuasive, and the *IFRS for SMEs* does not require the IFRS 7 disclosures.

Amortisation and impairment of goodwill and other indefinite-lived intangible assets

BC108 In their responses to the recognition and measurement questionnaire and at the round-table meetings, many preparers and auditors of SMEs' financial statements said that the requirement in IAS 36 *Impairment of Assets* for an annual calculation of the recoverable amount of goodwill and other indefinite-lived intangible assets is onerous for SMEs because of the expertise and cost involved. They proposed, as an alternative, that SMEs should be required to calculate the recoverable amount of goodwill and other indefinite-lived intangible assets only if impairment is indicated. They proposed, further, that the *IFRS for SMEs* should include a list of indicators of impairment as guidance for SMEs. The Board agreed with those proposals. Respondents to the exposure draft supported the Board's decision on an indicator approach to impairment. Consequently, the *IFRS for SMEs* establishes an indicator approach and includes a list of indicators based on both internal and external sources of information. In addition if goodwill cannot be allocated to individual cash-generating units (or groups of cash-generating units) on a non-arbitrary basis, then the *IFRS for SMEs* provides relief by letting the entity test goodwill for impairment by determining the recoverable amount of the acquired entity in its entirety if the goodwill relates to an acquired entity that has not been integrated. If the goodwill relates to an entity that has been integrated into the group, the recoverable amount of the entire group of entities is tested.

BC109 Many respondents to the recognition and measurement questionnaire and participants in the round-table discussions favoured requiring amortisation of goodwill and other indefinite-lived intangible assets over a specified maximum period. Proposals generally ranged from 10 to 20 years. They argued that amortisation is simpler than an impairment approach, even an impairment approach that is triggered by indicators. In developing the exposure draft, the Board did not agree with that proposal for three main reasons:

- (a) An amortisation approach still requires assessment of impairment, so it is actually a more complex approach than an indicator-triggered assessment of impairment.
- (b) Amortisation is the systematic allocation of the cost of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset over its useful life. By its nature, goodwill often has an indefinite life. Thus, if there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not faithfully represent economic reality.
- (c) When the IASB was developing IFRS 3 *Business Combinations* (as revised in 2008) and related amendments to IAS 38 *Intangible Assets*, most users of financial statements said they found little, if any, information content in the amortisation of goodwill over an arbitrary period of years.

Consequently, the exposure draft proposed an impairment-only approach to goodwill and other indefinite-lived intangible assets, combined with an indicator trigger for detailed impairment calculations.

- BC110 Many respondents to the exposure draft disagreed with the proposal not to require amortisation of goodwill. In fact, the single accounting recognition and measurement proposal in the exposure draft that was most frequently recommended for reconsideration was non-amortisation of goodwill. The great majority of the respondents addressing this issue recommended that amortisation of goodwill should either be permitted or be required over a limited number of years. Many of those respondents acknowledged the need for impairment testing in addition to, but not as a substitute for, amortisation. Moreover, respondents who held this view also felt that SMEs should not be required to distinguish between intangible assets with finite and indefinite useful lives. At their meeting in April 2008, working group members unanimously supported requiring amortisation of all intangibles, including goodwill, subject to an impairment test.
- BC111 Some respondents holding this view acknowledged that amortisation of goodwill and other indefinite-lived intangible assets may not be the most conceptually correct approach. However, from a practical standpoint, they pointed out that many smaller entities will find it difficult to assess impairment as accurately or as promptly as larger or listed entities, meaning the information could be less reliable. Amortisation, particularly if coupled with a relatively short maximum amortisation period, would reduce the circumstances in which an impairment calculation would be triggered. They also pointed out that in the context of SMEs, users of financial statements say they find little, if any, information content in goodwill at all; for example, lenders generally do not lend against goodwill as an asset.
- BC112 After considering the various views expressed, the Board concluded—for cost-benefit reasons, rather than conceptual reasons—that goodwill and other indefinite-lived intangible assets should be considered to have finite lives. Therefore, such assets should be amortised over their estimated useful lives, with a maximum amortisation period of ten years. The assets must also be assessed for impairment using the ‘indicator approach’ in the *IFRS for SMEs*.

Charge all development costs to expense

- 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.

Cost method for associates and jointly controlled entities

- BC115 IAS 28 requires an entity to account for its investments in associates by the equity method. IAS 31 allows an entity to account for its investments in jointly controlled entities by either the equity method or proportionate consolidation. Many preparers of SMEs' financial statements questioned the usefulness of both of those accounting methods and told the Board that SMEs have particular difficulty in applying those methods because of inability to obtain the required information and the need to conform accounting policies and reporting dates. In their view, the cost method—which is permitted under IAS 28 and IAS 31 in accounting for investments in associates and joint ventures in the investor's separate financial statements—should also be permitted under the *IFRS for SMEs* in the investor's consolidated financial statements. Lenders generally indicated that information reported using the equity method and proportionate consolidation is of limited use to them because it is not useful in assessing either future cash flows or loan security. Fair values are more relevant for those purposes. Recognising the special problems of SMEs in applying the equity and proportionate consolidation methods, and also the relevance of fair values for lenders, the Board concluded that SMEs should be permitted to use either the cost method or fair value through profit or loss.

Fair value through profit or loss for associates and jointly controlled entities with published price quotations

- BC116 IAS 28 requires investments in associates to be measured using the equity method. IAS 31 requires investments in jointly controlled entities to be measured using either the equity method or proportionate consolidation. Neither of those standards makes an accounting measurement distinction if such investments happen to have a published price quotation.
- BC117 The *IFRS for SMEs* requires that any investment in an associate or jointly controlled entity for which there is a published price quotation must be measured at fair value through profit or loss. The Board's reasons for reaching this decision were (a) concerns about measurement reliability are substantially eliminated, (b) the cost of obtaining a fair valuation is substantially eliminated and (c) such fair values are more relevant than cost-based measurements to lenders and other users of SMEs' financial statements.

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.

Borrowing costs

- 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.

Income tax

- 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.

Exchange differences on monetary items

- BC123 IAS 21 requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation. In the financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements when the foreign operation is a subsidiary), IAS 21 recognises such exchange differences initially in other comprehensive income and reclassifies them from equity to profit or loss on disposal of the net investment. The *IFRS for SMEs* provides for one difference: an exchange difference that is recognised initially in other comprehensive income is not reclassified in profit or loss on disposal of the investment. The reason for the difference is that not requiring reclassification is less burdensome for SMEs because it eliminates the need for tracking the exchange differences after initial recognition.

Less fair value for agriculture

- BC124 Some preparers and auditors of the financial statements of SMEs engaged in agricultural activities said that the 'fair value through profit or loss' model is burdensome for SMEs, particularly when applied to biological assets of those SMEs operating in inactive markets or developing countries. They said that the presumption in IAS 41 that fair value can be estimated for biological assets and agricultural produce is unrealistic with respect to biological assets of some SMEs. Some proposed that SMEs should be permitted or required to use a 'cost-depreciation-impairment' model for all such assets. The Board did not support this approach for the reasons explained in paragraph BC146. However, the Board concluded, both because of the measurement problems in inactive markets and developing countries and for cost-benefit reasons, that SMEs should be required to use the fair value through profit or loss model only when fair value is readily determinable without undue cost or effort. When that is not the case, the Board concluded that SMEs should follow the cost-depreciation-impairment model.

Employee benefits—measurement of the defined benefit obligation

- BC125 IAS 19 requires that a defined benefit obligation should always be measured using the projected unit credit actuarial method. For cost-benefit reasons, the *IFRS for SMEs* provides for some measurement simplifications that retain the basic IAS 19 principles but reduce the need for SMEs to engage external specialists. Therefore, the Board decided:
- (a) If information based on the projected unit credit calculations of IAS 19 is already available or can be obtained without undue cost or effort, SMEs must use that method.
 - (b) If information based on the projected unit credit method is not available and cannot be obtained without undue cost or effort, SMEs must apply an

approach that is based on IAS 19 but does not consider future salary progression, future service or possible mortality during an employee's period of service. This approach still takes into account life expectancy of employees after retirement age. The resulting defined benefit pension obligation reflects both vested and unvested benefits.

- (c) The *IFRS for SMEs* clarifies that comprehensive valuations would not normally be necessary annually. In the interim periods, the valuations would be rolled forward for aggregate adjustments for employee composition and salaries, but without changing the turnover or mortality assumptions.

Employee benefits—actuarial gains and losses of defined benefit plans

BC126 One of the principal complexities of IAS 19 is recognition of actuarial gains and losses. Under IAS 19, an entity can choose any of the following options:

- (a) recognise actuarial gains and losses in full in profit or loss when they occur.
- (b) recognise actuarial gains and losses in full directly in other comprehensive income when they occur.
- (c) amortise the excess of actuarial gains and losses over the greater of
- (i) 10 per cent of the present value of the defined benefit obligation at that date (before deducting plan assets) and
 - (ii) 10 per cent of the fair value of any plan assets at that date
- (with those limits calculated and applied separately for each defined benefit plan) divided by the average remaining working life of the employees.
- (d) recognise actuarial gains and losses in profit or loss using any systematic method that results in faster recognition than (c) above.

BC127 The *IFRS for SMEs* does not permit either of the deferral and amortisation methods described in (c) or (d). Instead, it requires immediate recognition with an option to present the amount either in profit or loss (method (a)) or in other comprehensive income (method (b)). Methods (a) and (b) are far simpler than either of the deferral and amortisation methods. Methods (c) and (d) require tracking of data over many years and annual calculations. Moreover, financial statement users generally have told the Board that they find immediate recognition (methods (a) and (b)) provides the most understandable and useful information.

Employee benefits—unvested past service cost of defined benefit plans

BC128 Past service cost relating to employee service in prior periods arises when a new defined benefit plan is introduced or an existing plan is changed. IAS 19 requires past service cost to be deferred and amortised as an expense (or, in the case of benefit reductions, as income) on a straight-line basis over the average period

until the benefits become vested. To the extent that the benefits vest immediately when a plan is introduced or changed, the past service cost is recognised in profit or loss immediately. The *IFRS for SMEs* requires immediate recognition of all past service cost (including that related to unvested benefits), without any deferral. The Board believes that the method in the *IFRS for SMEs* is simpler because it does not require tracking of data over many years or annual calculations. A deferred recognition model relegates important information about the funding status of post-retirement plans to the notes to the financial statements. Further, deferred recognition treats changes to an entity's pension assets and liabilities differently from changes to the entity's other assets and liabilities.

Share-based payment

- BC129 The exposure draft had proposed that SMEs should apply IFRS 2 in measuring equity-settled share-based payment transactions, and that the entity should make the disclosures required by IFRS 2. The Board's reasoning was that IFRS 2 already provided a simplification for SMEs because, if an entity is unable to estimate reliably the fair value of the equity instruments granted at the measurement date, the entity is permitted to measure the equity instruments at intrinsic value. Most respondents to the exposure draft said that the intrinsic value method is not much of a simplification as this method requires knowing the fair value of the underlying shares when the share option (or other share-based payment) is granted and at each subsequent reporting date. The working group shared this concern about IFRS 2.
- BC130 The Board considered the views of these respondents and the working group and concluded that further simplifications are appropriate for cost-benefit reasons. As a matter of principle, the Board concluded that SMEs should always recognise an expense for equity-settled share-based payments and that the expense should be measured on the basis of observable market prices, if available. If observable market prices are not available, SMEs should measure the expense using the directors' best estimate of the fair value of the equity-settled share-based payment. The Board also decided that disclosure only, without expense recognition, is not appropriate.
- BC131 The Board also decided that for SMEs' share-based payment transactions that give either the entity or the counterparty a choice of settlement in cash or equity instruments, the entity should account for the transaction as a cash-settled share-based payment transaction unless either
- (a) the entity has a past practice of issuing equity instruments under similar arrangements, or
 - (b) the option to settle in cash has no commercial substance.

In circumstances (a) and (b), the transaction is accounted for as equity-settled.

Transition to the *IFRS for SMEs*

- BC132 IFRS 1 requires an entity's first IFRS financial statements to include at least one year of comparative information under IFRSs. Some preparers and auditors of SMEs' financial statements explained to the Board that a requirement to prepare restated prior period data in all cases would be burdensome for SMEs adopting the

IFRS for SMEs for the first time. Thus, the *IFRS for SMEs* includes an ‘impracticability’ exemption. Similarly, it provides an impracticability exemption with respect to some requirements for restating the opening statement of financial position.

Investment property

- BC133 IAS 40 allows an accounting policy choice of either fair value through profit or loss or a cost-depreciation-impairment model (with some limited exceptions). An entity following the cost-depreciation-impairment model is required to provide supplemental disclosure of the fair value of its investment property. The *IFRS for SMEs* does not have an accounting policy choice but, rather, the accounting for investment property is driven by circumstances. If an entity knows or can measure the fair value of an item of investment property without undue cost or effort, it must use the fair value through profit or loss model for that investment property. It must use the cost-depreciation-impairment model for other investment property. Unlike IAS 40, the *IFRS for SMEs* does not require disclosure of the fair values of investment property measured on a cost basis.

Government grants

- BC134 The *IFRS for SMEs* requires a single, simplified method of accounting for all government grants. All grants are recognised in income when the performance conditions are met or earlier if there are no performance conditions. All grants are measured at the fair value of the asset received or receivable. IAS 20 permits a range of other methods that are not allowed by the *IFRS for SMEs*.

Exception from straight-line method by lessees for operating leases when payments compensate the lessor for inflation

- BC135 The *IFRS for SMEs* does not require a lessee to recognise lease payments under operating leases on a straight-line basis if the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor’s expected inflationary cost increases. That exception to the straight-line basis is not in IAS 17 *Leases*.

No annual review of useful life, residual value and depreciation/amortisation method

- BC136 The *IFRS for SMEs* does not require an annual review of the useful life, residual value, and depreciation or amortisation method for property, plant and equipment and intangible assets. Instead, a review is required only if there is an indication that there has been a significant change since the last annual reporting date. IAS 16 and IAS 38 require reviews at least at each financial year-end.

Simplifications considered but not adopted

- BC137 In developing the *IFRS for SMEs*, the Board considered some recognition and measurement simplifications that it decided not to adopt. Some of those potential simplifications were identified in existing national accounting

standards for SMEs. Some were proposed by the Board's constituents in their responses to the 2004 discussion paper or the recognition and measurement questionnaire in 2005. Those proposals, and the Board's reasons for rejecting them, are described in paragraphs BC138–BC150.

Not to require a cash flow statement

- BC138 Some suggested that the Board should not require SMEs to prepare a cash flow statement. Some who held this view believed that preparing a cash flow statement is burdensome. Some contended that users of SMEs' financial statements do not find the cash flow statement useful.
- BC139 The Board noted that if a comparative statement of financial position (with amounts for the beginning and the end of the reporting period) and an income statement are available, preparing a cash flow statement is not a difficult, time-consuming or costly task. The accounting frameworks of most jurisdictions require broad groups of entities, including SMEs, to prepare a cash flow statement. Moreover, the great majority of users of SMEs' financial statements who have communicated with the Board—including particularly lenders and short-term creditors—indicated that the cash flow statement is very useful to them.

Treat all leases as operating leases

- BC140 IAS 17 does not recognise a lessee's rights and obligations under a lease in the statement of financial position if the lease is classified as an operating lease. Although lessees obtain rights and incur obligations under all leases, finance leases create obligations substantially equivalent to those arising when an asset is purchased on credit. Information about such assets and obligations is important for lending and other credit decisions. Treating all leases as operating leases would remove useful information from the statement of financial position.

Treat all employee benefit plans as defined contribution plans

- BC141 As with leases, users of financial statements are concerned about 'off balance sheet obligations'. Many jurisdictions require SMEs by law to provide benefits that are the equivalent of a defined benefit pension plan—for example, long-service benefits. Users of SMEs' financial statements consistently say that information about the funding status of such obligations is useful and important to them.

Completed contract method for construction contracts

- BC142 The completed contract method can produce a potentially misleading accounting result for a construction contractor, with initial years of no profit at all followed by full recognition of profit when the construction is completed. Many construction contractors are SMEs. The fluctuation between years of large profit and years of large losses may be magnified for SMEs because they tend to have fewer contracts than larger entities. Users of financial statements have told the Board that, for a contractor, the percentage of completion method provides information that they find more useful than the completed contract method.

Fewer provisions

- BC143 Provisions are liabilities of uncertain timing or amount. Despite the uncertainties, they are obligations that have met the liability recognition criteria. Users of SMEs' financial statements consistently say they want these obligations recognised in the statement of financial position, with the measurement uncertainties explained.

Non-recognition of share-based payment

- BC144 Non-recognition is inconsistent with the definitions of the elements of financial statements, especially an expense. Moreover, users of financial statements generally hold the view that share-based payments to employees should be recognised as remuneration expense because (a) they are intended as remuneration, (b) they involve giving something of value in exchange for services and (c) the consumption of the employee services received is an expense. Although Section 26 requires recognition of the expense, it also provides for simplified measurement as compared with IFRS 2.

Non-recognition of deferred taxes

- 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.

Cost model for all agriculture

- BC146 Not only is fair value generally regarded as a more relevant measure in this industry, quoted prices are often readily available, markets are active, and measuring cost is actually more burdensome and arbitrary because of the extensive allocations required. Moreover, managers of most SMEs that undertake agricultural activities say that they manage on the basis of market prices or other measures of current value rather than historical costs. Users also question the meaningfulness of allocated costs in this industry.

No consolidated financial statements

BC147 In many countries, SMEs are organised into two or more legal entities for tax or other legal reasons, even though they operate as one economic entity. Investors, lenders and other users of SMEs' financial statements say that they find information about the financial position, operating results and cash flows of the economic entity useful for their decisions. They say they cannot use the separate financial statements of the legal entities because those entities often enter into transactions with each other that are not necessarily structured or priced on an arm's length basis. In such circumstances, the amounts reported in the separate statements reflect internal transactions (eg sales between the legal entities) that are not transactions of the economic entity with other economic entities. Also, the entities are often jointly managed, and loans are cross-collateralised. In the Board's judgement, consolidated statements are essential for users when two entities operate as a single economic entity.

Recognition of all items of income and expense in profit or loss

BC148 The *IFRS for SMEs* requires SMEs to recognise items of income or expense in other comprehensive income, rather than in profit or loss, in three circumstances:

- (a) Paragraph 12.23 requires SMEs to recognise changes in the fair value of some hedging instruments in other comprehensive income.
- (b) Paragraph 28.24 gives SMEs the option to recognise actuarial gains and losses either in profit or loss or in other comprehensive income.
- (c) Paragraph 30.13 provides that, in consolidated financial statements, SMEs must recognise in other comprehensive income a foreign exchange difference (gain or loss) arising on a monetary item that forms part of the reporting entity's net investment in a foreign operation (subsidiary, associate or joint venture).

BC149 In developing the *IFRS for SMEs*, the Board considered whether to require SMEs to recognise the foreign exchange gains or losses and actuarial gains and losses only in profit or loss, rather than as part of other comprehensive income. Because the *IFRS for SMEs* requires SMEs to present a statement of comprehensive income, the Board concluded not to require presentation of those gains and losses in profit or loss.

BC150 Because the Board has begun a comprehensive project on financial instruments as part of its convergence programme with the US Financial Accounting Standards Board, the Board did not consider requiring SMEs to recognise changes in the fair value of all hedging instruments in profit or loss at this time.

Issues addressed in the *IFRS for SMEs* that are not covered in full IFRSs

BC151 The *IFRS for SMEs* covers several issues that, in the Board's judgement, are relevant to SMEs but are not addressed in full IFRSs:

- (a) combined financial statements (paragraphs 9.28–9.30).
- (b) original issue of shares or other equity instruments (paragraphs 22.7–22.10).
- (c) sale of options, rights and warrants (paragraph 22.11).
- (d) capitalisation or bonus issues of shares and share splits (paragraph 22.12).

Optional reversion to full IFRSs by an entity using the IFRS for SMEs

BC152 The Board considered whether an entity using the *IFRS for SMEs* should be allowed to choose to apply a recognition or measurement principle permitted in a full IFRS that differs from the principle required by the related section of the *IFRS for SMEs*.

BC153 Some proposed that the *IFRS for SMEs* should, in effect, contain ‘optional simplifications of IFRSs’. Within this group, there were two schools of thought:

- (a) One school would permit SMEs to revert to full IFRSs principle by principle, while otherwise continuing to use the *IFRS for SMEs*.
- (b) The second school would permit SMEs to revert to a full IFRS in its entirety, but not principle by principle within an IFRS, while otherwise continuing to use the *IFRS for SMEs*. Those who hold this view believe that the recognition and measurement principles in a full IFRS are so interrelated that they should be regarded as an integrated package.

BC154 The alternative view is that an entity should be required to choose only either the complete set of full IFRSs or the complete *IFRS for SMEs*. The Board is of that view (with the sole exception of the option to apply IAS 39 for the reasons set out in paragraph BC106). Allowing SMEs optionally to revert to full IFRSs either principle by principle or standard by standard, while continuing to follow the *IFRS for SMEs* for other transactions and circumstances, would result in significant non-comparability. Undesirably, SMEs would have almost an infinite array of combinations of accounting policies from which to choose.

Presentation simplifications

BC155 On the basis of the needs of users of SMEs’ financial statements and costs to smaller entities, the Board concluded that the *IFRS for SMEs* should reflect the following simplifications of financial statement presentation:

- (a) An entity should not be required to present a statement of financial position as at the beginning of the earliest comparative period when the entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. IAS 1 would require such a presentation.
- (b) All deferred tax assets and liabilities should be classified as non-current assets or liabilities. The Board’s exposure draft *Income Tax* proposes that deferred taxes and liabilities should be classified as either current or

non-current according to the classification of the related non-tax asset or liability in the statement of financial position.

- (c) An entity is permitted to present a single statement of income and retained earnings in place of separate statements of comprehensive income and changes in equity if the only changes to its equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy. This option does not exist in full IFRSs.

Disclosure simplifications

BC156 The disclosure requirements in the *IFRS for SMEs* are substantially reduced when compared with the disclosure requirements in full IFRSs. The reasons for the reductions are of four principal types:

- (a) Some disclosures are not included because they relate to topics covered in IFRSs that are omitted from the *IFRS for SMEs* (see paragraph BC88).
- (b) Some disclosures are not included because they relate to recognition and measurement principles in full IFRSs that have been replaced by simplifications proposed in the draft IFRS (see paragraphs BC98–BC136).
- (c) Some disclosures are not included because they relate to options in full IFRSs that are not included in the *IFRS for SMEs* (see paragraphs BC84–BC86).
- (d) Some disclosures are not included on the basis of users' needs or cost-benefit considerations (see paragraphs BC44–BC47, BC157 and BC158).

BC157 Assessing disclosures on the basis of users' needs was not easy, because users of financial statements tend to favour more, rather than fewer, disclosures. The Board was guided by the following broad principles:

- (a) Users of the financial statements of SMEs are particularly interested in information about short-term cash flows and about obligations, commitments or contingencies, whether or not recognised as liabilities. Disclosures in full IFRSs that provide this sort of information are necessary for SMEs as well.
- (b) Users of the financial statements of SMEs are particularly interested in information about liquidity and solvency. Disclosures in full IFRSs that provide this sort of information are necessary for SMEs as well.
- (c) Information on measurement uncertainties is important for SMEs.
- (d) Information about an entity's accounting policy choices is important for SMEs.
- (e) Disaggregations of amounts presented in SMEs' financial statements are important for an understanding of those statements.
- (f) Some disclosures in full IFRSs are more relevant to investment decisions in public capital markets than to the transactions and other events and conditions encountered by typical SMEs.

BC158 The Board also relied on the recommendations of the working group, which undertook a comprehensive review of the disclosure proposals in the exposure draft, and the comments on those proposals in responses to the exposure draft. The working group sent its comprehensive recommendations to the Board in July 2008. In addition, the staff of the German Accounting Standards Committee met representatives of six German banks that lend extensively to small private entities and provided the IASB with a comprehensive report on disclosure needs from a bank lender's perspective.

Why a separate volume rather than added sections in each IFRS

BC159 The Board saw merit in two approaches—publishing the *IFRS for SMEs* in a separate volume and publishing a separate section in each individual IFRS (including Interpretations). The principal advantages of the separate volume are:

- (a) ease of use for those seeking to apply the *IFRS for SMEs*. If the *IFRS for SMEs* addresses the transactions, events and conditions typically encountered by SMEs, much of the material in full IFRSs would not normally have application for SMEs.
- (b) the *IFRS for SMEs* can be drafted in a simplified language without the details that are needed in full IFRSs.

BC160 The advantages of including the requirements for SMEs as a separate section of each IFRS (including Interpretations) include:

- (a) the modifications or exemptions are highlighted.
- (b) to the extent that SMEs may choose to look to full IFRSs, putting both the requirements for SMEs and the related full standards in one place is more user-friendly.
- (c) it would reduce the likelihood that, in drafting the *IFRS for SMEs*, an unintended difference will arise between an IFRS and the related requirements in the *IFRS for SMEs*.

BC161 Respondents to the discussion paper generally favoured the separate volume approach. On balance the Board agreed for the reasons outlined in paragraph BC159.

Why organisation by topic

BC162 The Board saw merit both in sequentially organising the requirements for SMEs similarly to full IFRSs and in topical organisation. Using the same organisation and numbering system as full IFRSs would enable a user to link back to the full IFRS to seek further guidance on an accounting question. Topical organisation, on the other hand, would make the *IFRS for SMEs* more like a reference manual, which is likely to be the way that people would use it, and thus it would be more user-friendly. Indexing could minimise the benefits of one of those approaches over the other. Providing the *IFRS for SMEs* in electronic form could also minimise the benefits of one approach over the other. Most respondents to the discussion paper and the exposure draft favoured organisation by topic. On balance the Board found the benefits of a topically organised reference manual persuasive.

The Board's plan for maintaining (updating) the *IFRS for SMEs*

- BC163 In the discussion paper, the Board expressed a tentative view that, 'once the initial *IFRS for SMEs* is in place, concurrently with each exposure draft of an IFRS and each draft Interpretation, and most likely as part of those documents, the Board will propose the related requirements for SMEs. The effective dates of the new or revised requirements for SMEs would probably be the same as the effective date of the new or revised IFRSs (including Interpretations).' In general, respondents to the discussion paper did not agree with this approach. They explained that because SMEs do not have internal accounting resources or the ability to hire accounting advisers on an ongoing basis, the *IFRS for SMEs* should be updated only periodically, perhaps only once in two or three years. They also noted that not every new IFRS or Interpretation or amendment to an IFRS or Interpretation will affect the *IFRS for SMEs*. On the basis of users' needs or cost-benefit considerations, some of those changes may be relevant only for full IFRSs. Furthermore, there may be some changes to the *IFRS for SMEs* that are appropriate even if full IFRSs are not changed.
- BC164 The principal benefits of considering changes to the *IFRS for SMEs* at the same time as each new IFRS is proposed or each amendment to an existing IFRS is proposed are consistency of consideration both by the Board and respondents, avoiding a time lag between when changes affect full IFRSs and when similar changes affect the *IFRS for SMEs*, and avoiding potentially differing standards in full IFRSs and the *IFRS for SMEs*.
- BC165 On balance, the Board found the arguments set out in paragraph BC163 for periodic, rather than contemporaneous, updating of the *IFRS for SMEs* generally persuasive. Accordingly, the Board has decided:
- (a) to undertake a thorough review of SMEs' experience in applying the *IFRS for SMEs* when two years of financial statements using the IFRS have been published by a broad range of entities and, based on that review, to propose amendments to address implementation issues. At that time, the Board will also consider new and amended IFRSs that have been adopted since the *IFRS for SMEs* was issued.
 - (b) after that initial implementation review, to propose amendments to the *IFRS for SMEs* by publishing an omnibus exposure draft approximately once every three years.

Paragraphs P16–P18 of the Preface to the *IFRS for SMEs* explain the Board's plan for maintaining the *IFRS for SMEs*.

Dissenting opinion on *International Financial Reporting Standard for Small and Medium-sized Entities*

Dissent of James J Leisenring

- DO1 Mr Leisenring dissents from the issue of the IFRS because he believes that the *IFRS for SMEs* is neither necessary nor desirable.
- DO2 It is unnecessary because the vast majority of accounting policy decisions of SMEs are straightforward and extensive reference to IFRSs will not be required and, when required, not burdensome.
- DO3 It is undesirable because the IFRS would produce non-comparable information. SMEs will not be comparable with each other and will not be comparable with publicly accountable entities. That result is inconsistent with the IASB *Framework* and the concepts and pervasive principles of the IFRS.
- DO4 Non-comparability will result because the IFRS would allow SMEs, as a result of paragraph 10.5, to ignore the requirements of other IFRSs even when the specific accounting issue is addressed in those IFRSs. If an entity is satisfied with the result of applying paragraph 10.5(a) and (b) there is never a requirement to look to full IFRSs. Thus, identical transactions can be accounted for differently by different SMEs and differently from publicly accountable entities. If the Board finds it necessary to develop educational materials to assist SMEs in applying IFRSs, that would certainly be appropriate. However, Mr Leisenring believes that in all circumstances IFRSs should ultimately be the source of accounting guidance for all entities.
- DO5 Mr Leisenring does not believe that the Board has demonstrated the need to make modifications to recognition and measurement requirements in IFRSs for application by SMEs on the basis of either cost-benefit analysis or user needs. As a result, he would not have any differences in recognition and measurement requirements from full IFRSs. Alternatively, he would much more extensively modify the disclosure requirements to meet special user needs. That modification might well create disclosures not required at present, such as information about economic dependency and common control.
- DO6 Mr Leisenring also believes that the IFRS is inconsistent with the Constitution of the International Accounting Standards Committee Foundation and the *Preface to International Financial Reporting Standards*. Those documents set out an objective of a single set of accounting standards taking account of the special needs of small and medium-sized entities and emerging economies. Mr Leisenring accepts that objective but does not believe it implies separate sets of standards for entities in differing circumstances as indicated in paragraph BC42. The conclusion of that paragraph suggests that many sets of accounting standards would be appropriate depending on different circumstances.