STAFF PAPER

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IASB Meeting

Project	**Comprehensive review of the *IFRS for SMEs***		
Paper topic	Development of the *IFRS for SMEs* (education session)		
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Purpose of this paper

1. Agenda Paper 8A (this agenda paper) explains how the *IFRS for SMEs* was developed and provides a summary of the key simplifications from full IFRSs as at the date the *IFRS for SMEs* was issued (June 2009). This agenda paper will provide the basis for a short education session.

Introduction

2. At the March 2013 IASB meeting a few IASB members noted that before deciding whether local authorities/standard-setters should be able to permit wider use of the *IFRS for SMEs* they would like to be provided with an analysis of the simplifications made from full IFRSs at the time the *IFRS for SMEs* was developed. It was noted that a similar analysis would also be useful to local authorities/standard-setters because it would describe the main changes to an entity's financial statements if it moved from full IFRSs to the *IFRS for SMEs*. This would enable local authorities/standard-setters to better understand the consequences of widening the scope.

3. This agenda paper answers the following questions:

   (a) What is the scope of the *IFRS for SMEs*?

(b) What was the starting point for developing the *IFRS for SMEs*?

(c) How was the *IFRS for SMEs* simplified?

(d) Is the *IFRS for SMEs* linked to full IFRSs or is it a stand-alone Standard?

(e) How will the *IFRS for SMEs* be updated and maintained?

What is the scope of the *IFRS for SMEs*?

4. The *IFRS for SMEs* is intended for use by SMEs. SMEs are defined as entities that publish general purpose financial statements for external users but do not have public accountability.

5. An entity has public accountability 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, or

   (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

6. Therefore, any entity of any size is eligible to use the *IFRS for SMEs*, provided it does not have public accountability. When deciding on the scope of the *IFRS for SMEs*, the IASB concluded that it is not feasible to develop quantified size tests that would be applicable and long-lasting across all countries. However, the IASB noted that in deciding which entities should be required or permitted to use the *IFRS for SMEs*, jurisdictions may choose to prescribe their own quantified size criteria.

7. Some interested parties 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 thousands of employees down to 'micro-sized' entities with fewer than ten employees. However, the *IFRS for SMEs* is designed for entities 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 micro-sized SMEs as it is for larger SMEs. Financial statements prepared using the *IFRS for SMEs* are intended to meet those needs.

8. The *IFRS for SMEs* is not intended for SMEs that are preparing financial statements solely for tax reasons or to comply with company law. However, those entities may still find the *IFRS for SMEs* helpful in preparing such financial statements.

What was the starting point for developing the *IFRS for SMEs*?

9. The *IFRS for SMEs* was developed by
   (a) extracting the fundamental concepts from the *Framework* and the principles and related mandatory guidance from full IFRSs including Interpretations (generally the 'bold letter' principles), and
   (b) considering the modifications that are appropriate based on two criteria:
      (i) the needs of users of SME financial statements, and
      (ii) cost-benefit considerations (explained further in paragraph 10).

10. In practice, the benefits of applying accounting requirements differ between publicly accountable entities and entities without public accountability because of the different information needs of the users of their financial statements. However, the related costs may not differ significantly. This is because the size of an entity and/or the resources available to it are more likely to influence how costly an accounting requirement is to apply, rather than whether that entity has public accountability. Therefore, during development of the *IFRS for SMEs* the IASB 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.

11. When deciding on the starting point for developing the *IFRS for SMEs*, the IASB judged that using full IFRSs was 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.

12. The IASB rejected a '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.

13. Paragraph BC45 in the Basis for Conclusions accompanying the *IFRS for SMEs* provides a summary of the IASB's analysis of how the needs of users of SME financial statements are likely differ from those of publicly accountable entities:

> 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.

How was the *IFRS for SMEs* simplified?

14. The *IFRS for SMEs* is 230 pages, as compared to 2,855 pages in the 2009 IFRS 'Bound Volume' at the time the *IFRS for SMEs* was developed.

15. The *IFRS for SMEs* contains five types of simplifications of full IFRSs:

    (a) some topics in IFRSs are omitted (paragraph 17 below);

    (b) some accounting policy options in full IFRSs are not allowed because a more simplified method is available (paragraph 18 below);

    (c) many of the recognition and measurement principles that are in full IFRSs are simplified (paragraphs 19 to 55 below);

    (d) disclosures are substantially reduced (paragraphs 57-58 below); and

(e) drafting is simplified.

16. The *IFRS for SMEs* also provides additional guidance in two areas that the IASB decided would be helpful to SMEs (but are not addressed in full IFRSs):

(a) combined financial statements (Section 9); and

(b) issues of shares and other equity instruments (Section 22).

Omitted topics

17. The *IFRS for SMEs* does not address the following topics covered in full IFRSs because these topics are not considered relevant to the typical SME:

(a) earnings per share;

(b) interim financial reporting; and

(c) segment reporting.

Note, to the extent that an SME considers one or more of these topics to be relevant to its activities, nothing in the *IFRS for SMEs* would prevent the SME from providing such information *in addition to* the requirements of the *IFRS for SMEs* (and also referring to full IFRSs for guidance if it wishes to do so).

Omitted options

18. The significant accounting policy options permitted in full IFRSs (in 2009), but not permitted in the *IFRS for SME* are set out below:

(a) **Financial instruments (Section 11&12).** Does not have available-for-sale, held-to-maturity and fair value options.

(b) **Jointly-controlled entities (Section 15).** Does not permit proportionate consolidation.

(c) **Investment property (Section 16).** The accounting for investment property is driven by operational considerations. IAS 40 allows an accounting policy choice between the cost and fair value models. Section 16 requires an entity to use the fair value through profit or loss model for an investment property unless doing so would require undue cost or effort. If undue cost or effort is required, it must use the cost model.

(d) **Property, plant and equipment and intangible assets (Section 17&18).** Does not permit the revaluation model.

(e) **Government grants (Section 24).** Prescribes a single method of accounting for government grants based on the method required under full IFRSs for government grants related to biological assets measured at fair value (see IAS 41 *Agriculture*). Section 24 does not permit the choice of methods provided under IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

(f) **Actuarial gains and losses (Section 28)**. All actuarial gains and losses must be recognised immediately either in profit of loss or other comprehensive income. Section 28 does not permit the other methods of recognising actuarial gains and losses (including a 'corridor' approach) under IAS 19 *Employee Benefits*.

Main recognition and measurement simplifications (as at 2009)

19. Paragraphs 20-55 set out the main recognition and measurement simplifications in the *IFRS for SMEs*. However, because the *IFRS for SMEs* is drafted in simple language and includes much less guidance on how to apply the principles, other differences may arise in practice.

Financial instruments (Section 11&12)[1]

20. **Classification.**

(a) Under the *IFRS for SMEs* financial instruments meeting specified criteria are measured at amortised cost (classified on similar basis to

[1] Paragraph 11.2 of the *IFRS for SMEs* permits an entity to apply IAS 39 *Financial Instruments: Recognition and Measurement* as an accounting policy choice (the so called 'fallback option'). These differences would not apply if an entity applies the recognition and measurement provisions of IAS 39.

IFRS 9 *Financial Instruments*). All others are measured at fair value through profit or loss.

(b) Full IFRSs (IAS 39) is more complex because of the two additional categories (available-for-sale and held-to-maturity), the fair value option and the associated assessment of intentions and 'tainting' requirements.

21. **Derecognition.**

(a) The *IFRS for SMEs* establishes a simple principle for derecognition.

(b) Derecognition requirements under IAS 39 are more complex as they include additional 'pass-through' and 'continuing involvement' tests.

22. **Embedded derivatives.**

(a) The *IFRS for SMEs* does not require separate accounting for embedded derivatives. Generally, non-financial contracts that include an embedded risk (embedded derivative) with economic characteristics not closely related to the host contract, are required to be accounted for in their entirety at fair value.

(b) IAS 39 requires separate accounting for embedded derivatives.

23. **Types of hedging relationships.**

(a) The *IFRS for SMEs* focuses on the types of hedging relationships that SMEs are likely to use and only allows hedge accounting for the following:

(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 commodity; and

(iv) foreign exchange risk in a net investment in a foreign operation.

(b) The *IFRS for SMEs* focuses on hedging exposure to the specific risks listed above. IAS 39 allows hedging of the entire hedged item (ie exposure to all risks).

(c) Under the *IFRS for SMEs* hedge accounting cannot be achieved for the following strategies permitted by IAS 39:

(i) using debt instruments (‘cash instruments’) as hedging instruments. IAS 39 permits this for a hedge of foreign currency risk;

(ii) for an option-based hedging strategy; and

(iii) for portfolios.

24. **Hedge effectiveness**.

(i) The *IFRS for SMEs* 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.

(ii) Testing hedge ineffectiveness is stricter under IAS 39. Also IAS 39 would require discontinuation of hedge accounting prospectively starting at the date the conditions were no longer met.

Investments in associates (Section 14)

25. The *IFRS for SMEs* permits an entity to account for investments in associates in its primary financial statements using three different models—the equity method, the cost model[2] and the fair value model. The chosen model is applied to all investments in associates.

[2] If an SME uses the cost model, it is required to measure its investments for which there is a published price quotation using the fair value model (see paragraph 14.7 and 15.12 of the *IFRS for SMEs*)

26. Full IFRSs require investments in associates to be accounted for using the equity method in an investor's primary financial statements.

Investments in jointly-controlled entities (Section 15)

27. Like investments in associates, the *IFRS for SMEs* permits an entity to choose to account for investments in jointly controlled entities in its primary financial statements using one of three different models—the equity method, the cost model[2] and the fair value model. The chosen model is applied to all investments in jointly controlled entities.

28. Full IFRSs (IAS 31 *Interests in Joint Ventures*) require investments in jointly controlled entities to be accounted for using the equity method or proportionate consolidation in an investor's primary financial statements (an accounting policy choice).

Estimates for property, plant and equipment and intangible assets (Section 17&18)

29. Residual value, useful life and depreciation method for items of property, plant and equipment, and amortisation period/method for intangible assets, need to be reviewed only if there is an indication they may have changed since the most recent annual reporting date.

30. Full IFRSs require an annual review.

Development costs (Section 18)

31. The *IFRS for SMEs* requires all research and development costs to be recognised as expenses.

32. Full IFRSs require development costs meeting specific criteria to be capitalised.

Useful life of intangible assets (Section 18)

33. The *IFRS for SMEs* considers all intangibles to have finite lives. Intangible assets are amortised over their estimated useful lives (ten years is used if the useful life cannot be estimated reliably). An impairment test is performed only if there is an indication of impairment.

34. Under full IFRSs, indefinite-life intangible assets are not amortised and are instead subject to an impairment test at least annually and, additionally, when there is an indication of impairment. Full IFRSs do not provide a presumptive period if the useful life cannot be estimated reliably.

Goodwill (Section 19&27)

35. **Accounting for goodwill**.

    (a) Under the *IFRS for SMEs*, goodwill is amortised over its estimated useful life (ten years is used if useful life cannot be estimated reliably). An impairment test is performed only if there is an indication of impairment.

    (b) Under full IFRSs, goodwill is not amortised. It is subject to an impairment test at least annually and, additionally, when there is an indication of impairment.

36. **Impairment test.**

    (a) Under the *IFRS for SMEs* if goodwill cannot be allocated to individual cash-generating units (or groups of cash-generating units) on a non-arbitrary basis, entities are permitted to test goodwill for impairment by determining the recoverable amount of:

        (i) the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated (ie restructured or dissolved into the group); or

        (ii) the entire group of entities (excluding entities not integrated) if the goodwill relates to an acquired entity that has been integrated.

    (b) Full IFRSs do not have a similar simplification.

Operating leases (Section 20)

37. The *IFRS for SMEs* does not require a lessee or lessor to recognise lease payments under operating leases on a straight-line basis when 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.

38. Full IFRSs do not have any exceptions to the straight-line basis.

Borrowing costs (Section 25)

39. The *IFRS for SMEs* require borrowing costs to be charged to expenses.

40. Full IFRSs require 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.

Share-based payments (SBPs) giving counterparty a choice of settlement (Section 26)

41. The *IFRS for SMEs* requires the transaction to be accounted for as a cash-settled SBP unless the entity has a past practice of issuing equity instruments or the cash option has no commercial substance (then is it accounted for as an equity-settled SBP).

42. Full IFRSs require the separate identification and measurement of the equity component and the debt component of the compound financial instrument that is created.

Group SBP plans (Section 26)

43. The *IFRS for SMEs* permits a subsidiary to recognise and measure the expense and related capital contribution on a reasonable allocation of the group expense where a parent grants an award to employees of its subsidiary and the parent presents consolidated financial statements using the *IFRS for SMEs* or full IFRSs.

44. Full IFRSs do not have a similar simplification.

Non-current assets held-for-sale (Section 27)

45. Under the *IFRS for SMEs* holding an asset (or group of assets) for sale is an impairment indicator. However separate presentation in the statement of financial position of 'non-current assets held for sale' is not required.

46. Full IFRSs require a non-current asset held for sale (or disposal group) to be carried at the lower of its carrying amount and fair value less estimated costs to sell. Full IFRSs also require its separate presentation in the statement of financial position.

Defined benefit plans (Section 28)

47. **Projected unit credit actuarial method**.

    (a) The *IFRS for SMEs* provides for some measurement simplifications that retain the basic principles in IAS 19 *Employee Benefits* but reduce the need for SMEs to engage external specialists. An entity is required to use the projected unit credit method only if it is possible to do so without undue cost or effort. Otherwise, SMEs can apply a similar approach that does not consider future salary increases, future service or possible in-service mortality. Furthermore, the *IFRS for SMEs* clarifies that comprehensive valuations would not normally be necessary annually.

    (b) Full IFRSs require that a defined benefit obligation should always be measured using the projected unit credit actuarial method.

48. **Past service cost**.

    (a) Under the *IFRS for SMEs* an entity is required to recognise past service costs as an expense immediately.

    (b) Full IFRS requires an entity to recognise unvested past service cost as an expense on a straight-line basis over the average period until the benefits become vested.

Income tax (Section 29)

49. The *IFRS for SMEs* follows the approach set out in the Board's Exposure Draft *Income Tax*, published in March 2009, which intended to propose a simplified replacement for IAS 12 *Income Taxes*. The exposure draft was never adopted, and hence there are a number of differences (this is addressed in more detail in Agenda Paper 8F (Issue 8)).

Cumulative exchange differences that relate to a foreign operation (Section 30):

50. The *IFRS for SMEs* does not allow cumulative exchange differences that relate to a foreign operation that were previously recognised in other comprehensive income to be reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognised. This eliminates the need to track the exchange differences after initial recognition.

51. Full IFRSs require such a treatment.

Biological assets (Section 34):

52. The *IFRS for SMEs* requires an entity to use the fair value through profit or loss model for a biological asset unless doing so would require undue cost or effort. If undue cost or effort is required, it must use the cost model.

53. Full IFRSs specifies that an entity can only use the cost model on initial recognition for biological assets for which market-determined prices or values are not available and for which alternative estimates of fair value are determined to be clearly unreliable.

Transition to the IFRS for SMEs (Section 35):

54. **General 'impracticability' exemption**.

    (a) Under the *IFRS for SMEs* restatement of the opening statement of financial position for one or more adjustments is not required if impracticable. Similarly comparative disclosures are not required if providing them is impracticable.

    (b) Full IFRSs do not have a general 'impracticability' exemption.

55. **Deferred tax.**

    (a) Under the *IFRS for SMEs* a first-time adopter is not required to recognise, at the date of transition, deferred tax assets or deferred tax liabilities if recognition would involve undue cost or effort.

    (b) Full IFRSs do not have a similar exemption.

Presentation simplifications

56. The *IFRS for SMEs* includes the following simplifications for the presentation of the financial statements:

    (a) Under the *IFRS for SMEs* 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.

    (b) Under the *IFRS for SMEs* an entity is not 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.

Disclosure simplifications

57. The disclosure requirements in the *IFRS for SMEs* are substantially reduced when compared with the disclosure requirements in full IFRSs (roughly 400 as compared to 3,000 in full IFRSs in 2009). The IASB's 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 17).

    (b) Some disclosures are not included because they relate to options in full IFRSs that are not included in the *IFRS for SMEs* (see paragraph 18)

    (c) 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 *IFRS for SMEs* (see paragraphs 20-55).

    (d) Some disclosures are not included on the basis of users' needs or cost-benefit considerations (see paragraphs 9-13).

58. Paragraph BC157-BC158 in the Basis for Conclusions accompanying the *IFRS for SMEs* gives the broad principles applied by the IASB when making decisions on the disclosure requirements:

> 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.
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> (e) Disaggregations of amounts presented in SMEs' financial statements are important for an understanding of those statements.
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> (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
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> 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

The *IFRS for SMEs* is a stand-alone Standard

59. There are no circumstances under which an entity is **required** to look to full IFRSs. In addition, the only optional fallback to full IFRSs is the option to use the recognition and measurement requirements in IAS 39 instead of Section 11 and Section 12.

60. If the *IFRS for SMEs* does not specifically address a transaction, other event or condition, there is no requirement to look to full IFRSs. Instead management is required to use judgement in developing and applying an accounting policy that that is reliable and results in information that is relevant to the economic decision-

making needs of users. The *IFRS for SMEs* establishes the following hierarchy for an entity to follow in deciding on an appropriate accounting policy:

(a) requirements and guidance in the *IFRS for SMEs* dealing with similar and related issues, and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principle*s.

61. In making the judgement, management may, but is not required to, consider the requirements and guidance in full IFRSs dealing with similar and related issues. Therefore in the absence of specific guidance, the *IFRS for SMEs* permits full IFRSs principles to be used but only if they do not conflict with requirements in the hierarchy in paragraph 60(a) and (b).

Updating and maintaining the *IFRS for SMEs*

62. When the IASB issued the *IFRS for SMEs* in July 2009, it stated that it planned to undertake an initial comprehensive review of SMEs' experience in applying the *IFRS for SMEs* when two years of financial statements using the *IFRS for SMEs* have been published by a broad range of entities and, based on that review, to propose amendments to address implementation issues. The IASB also stated that it will consider new and amended IFRSs that have been adopted since the *IFRS for SMEs* was issued.

63. After the initial comprehensive review, the IASB said it expects to propose amendments to the *IFRS for SMEs* by publishing an omnibus exposure draft approximately once every three years. In developing those exposure drafts, the IASB said it would consider new and amended IFRSs that have been adopted in the previous three years as well as specific issues that have been brought to its attention regarding possible amendments to the *IFRS for SMEs*. The IASB intends the three-year cycle to be a tentative plan, not a firm commitment.

64. The IASB also said it expects that there will be a period of at least one year between when amendments to the *IFRS for SMEs* are issued and the effective date of those amendments.