STAFF PAPER

April 2013

IASB Meeting

Project	**Comprehensive review of the *IFRS for SMEs***
Paper topic	Scope of the *IFRS for SMEs* - Considering use by publicly accountable entities

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Purpose of this paper

1. Agenda Paper 8B (this agenda paper) asks the IASB to continue its discussions on whether the scope requirements of the *IFRS for SMEs* are currently too restrictive for publicly accountable entities.

2. This agenda paper builds on discussions at the March 2013 IASB meeting on the following issues from Agenda Paper 6A for that meeting:

    (a) Issue 1: Use by publicly traded entities (Question S1 in the Request for Information (RFI))

    (b) Issue 2: Use by financial institutions and similar entities (Question S2 in the RFI)

Structure of this paper

3. This agenda paper is set out as follows:

    (a) Introduction

    (b) Why are we considering deleting paragraph 1.5?

    (c) Staff analysis

(d) Staff recommendation

(e) Questions for the IASB to discuss

Introduction

4. At its March 2013 meeting the IASB started to discuss whether the scope requirements of the *IFRS for SMEs* are currently too restrictive for publicly accountable entities (Issues 1 and 2 for that meeting). No decisions were made.

5. The IASB staff would like the IASB to continue this discussion and make a tentative decision on use of the *IFRS for SMEs* by publicly accountable entities. The staff think it is important that the IASB starts off this comprehensive review with a clear view on which entities the *IFRS for SMEs* is intended for, and also whether any other entities should be permitted to apply and state compliance with it. The staff think without this clarity it will be difficult for the IASB to make decisions on whether to amend specific requirements in the *IFRS for SMEs* (eg which requirements in new and revised IFRSs should be incorporated, whether additional accounting policy options should be permitted etc).

6. Paragraph 1.1 and 1.2 of the *IFRS for SMEs* state that the intended scope of the *IFRS for SMEs* is entities that do not have public accountability and publish general purpose financial statements for external users. Paragraph 1.3 of the *IFRS for SMEs* sets out the definition of public accountability:

> 1.3 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 (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.

7. The IASB cannot prohibit jurisdictions from permitting or requiring publicly accountable entities to use the *IFRS for SMEs*. However, publicly accountable entities are currently prohibited from stating compliance with the *IFRS for SMEs* in their financial statements. Paragraph 1.5 of the *IFRS for SME* states:

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

8. At its March 2013 meeting the IASB considered whether paragraph 1.5, read with paragraph 1.3 is too restrictive. Specifically, the IASB considered the staff and SME Implementation Group (SMEIG) recommendation that jurisdictions should be able to decide which entities are able to use and state compliance with the *IFRS for SMEs*. Some IASB members proposed that, if a jurisdiction decided to permit use of the *IFRS for SMEs* by publicly accountable entities, those entities should be required to disclose that they are not within the intended scope of the *IFRS for SMEs*.

9. The IASB concluded that it needed additional clarity about how such a disclosure requirement would be expressed before it was able to make a decision. Therefore for this meeting the staff have prepared a revised recommendation which includes a suggested disclosure requirement.

10. At the March 2013 IASB meeting the staff presented the IASB with comment letter analysis and also the SMEIG recommendation on Issues 1 and 2. These are available in Agenda Paper 6A for the March 2013 meeting and have not been repeated in this agenda paper.

Why are we considering deleting paragraph 1.5?

11. The RFI asked for feedback on whether the scope of the *IFRS for SMEs* is too restrictive for publicly accountable entities. The IASB requested this feedback because several interested parties have said that the *IFRS for SMEs* would improve reporting for some publicly accountable entities. Their reasons include:

    (a) There are different degrees of 'public accountability'. Some entities meeting the definition of public accountability in the *IFRS for SMEs* are borderline cases and the needs of the users of their financial statements may be similar to the needs of users of entities without public accountability.

(b) Some jurisdictions have not adopted full IFRSs for all publicly accountable entities, eg because of the perceived complexity or lack of resources in the jurisdiction. Currently those entities may be applying local standards that are inferior to the *IFRS for SMEs*.

(c) Some publicly accountable entities are currently producing poor quality financial information under full IFRSs because of lack of expertise or resources available to them.

Staff analysis

12. The staff think there are three questions for the IASB to answer at this meeting:

(a) Should any changes be made to the intended scope of the *IFRS for SMEs*?

(b) Should paragraph 1.5 be replaced/deleted?

(c) If paragraph 1.5 is replaced/deleted, should the IASB provide additional guidance to help local authorities/standard-setters decide whether to permit any publicly accountable entities to use the *IFRS for SMEs* in their jurisdiction?

Should any changes be made to the intended scope of the IFRS for SMEs?

13. The intended scope of the *IFRS for SMEs* refers to the class of entities, and the related needs of their users, that the IASB considered when developing the *IFRS for SMEs*.

14. The intended scope of the *IFRS for SMEs* is entities without public accountability. Paragraph BC55 in the Basis for Conclusions accompanying the *IFRS for SMEs* provides the IASB's reasoning when developing the *IFRS for SMEs* for setting an intended scope:

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.*

15. The requirements in the *IFRS for SMEs* were simplified from full IFRSs for entities without public accountability using the twin criteria of user needs and cost-benefits (see paragraphs 9-13 of Agenda Paper 8A for a detailed explanation). If the intended scope of the *IFRS for SMEs* is amended, the IASB would need to consider whether the requirements in the *IFRS for SMEs* are still appropriate for the revised class of entities in the intended scope.

Should paragraph 1.5 be replaced/deleted?

16. If paragraph 1.5 is deleted this would not directly affect the intended scope of the *IFRS for SMEs*. However, it may influence decisions made by the IASB regarding it.

17. Paragraph 1.5 does not prevent publicly accountable entities from applying the *IFRS for SMEs*. It prevents them from stating compliance with the *IFRS for SMEs*. Therefore, if paragraph 1.5 is deleted, the staff believe the main concern that may arise is users of the financial statements will not be alerted to the fact that a publicly accountable entity is applying a Standard that was not designed for it.

18. On the basis of discussions at the March 2013 IASB meeting, the staff think there are three options:

(a) **Option 1:** Retain paragraph 1.5. All publicly accountable entities would continue to be prohibited from stating compliance with the *IFRS for SMEs* in their financial statements.

(b) **Option 2:** Replace paragraph 1.5 with a disclosure requirement for entities meeting the definition of public accountability in paragraph 1.3. For example:

(i) The disclosure would state that the entity has public accountability as defined in the *IFRS for SMEs*, and

(ii) The disclosure could also require an entity to provide other information that would be helpful to users, for example:

1. Explain why the entity meets the definition of public accountability in the *IFRS for SMEs*.
2. Explain why the entity has chosen to apply the *IFRS for SMEs*.

(c) **Option 3:** Delete paragraph 1.5.

Under Option 2 and 3 the local authority/standard-setter would be able to decide which entities can use and state compliance with the *IFRS for SMEs* in its jurisdiction.

Should additional guidance be provided to local authorities/standard-setters?

19. The current definition of public accountability is a bright line test, in that any entity which is either publicly traded or holds assets in a fiduciary capacity for a broad group of outsiders is considered to have public accountability. As a consequence, under certain circumstances, entities that economically or operationally meet the underlying intended scope of the *IFRS for SMEs* may be scoped out.

20. If paragraph 1.5 is deleted or replaced by a disclosure requirement (ie Option 2 or 3 in paragraph 18), the IASB may wish to provide additional guidance to help jurisdictions decide whether the *IFRS for SMEs* is appropriate for the needs of any entities meeting the definition of public accountability in their jurisdiction. For example, the guidance could explain how to identify if a publicly accountable entity has similar characteristics to entities without public accountability, eg users of their financial statements have similar needs, and explain the consequences of allowing such entities to use the *IFRS for SMEs*, eg how the financial information provided to users will be affected.

21. Some respondents told us that the meaning of fiduciary is unclear as it is a term with different implications across jurisdictions. The IASB may wish to provide additional guidance to clarify its intention when using the term to help local authorities/standard-setters and entities apply the current definition of public accountability.

Staff recommendation (revised from March 2013 meeting)

22. The staff recommend that paragraph 1.5 of the *IFRS for SMEs* is deleted. The staff believe in some cases it may be beneficial for local authorities/standard-setters to permit entities with public accountability (as currently defined) to apply the *IFRS for SMEs* in their jurisdiction in order to improve their financial reporting. Consequently staff think paragraph 1.5 is unduly restrictive. The staff believe that local authorities/standard-setters in individual jurisdictions should be able to decide which entities can use and state compliance with the *IFRS for SMEs*.

23. The staff believe that the *IFRS for SMEs* should remain clear that its intended scope is entities that do not have public accountability and its requirements should not be amended to cater for publicly accountable entities. The staff believe the primary aim when developing the *IFRS for SMEs* was to provide a standalone, simplified, set of accounting principles for entities that do not have public accountability, have less complex transactions, have limited resources to apply full IFRSs and operate in circumstances where comparability with their listed peers is not a key consideration. This primary aim should not be undermined by trying to cater for a broader scope of entities, eg if any publicly accountable entities use the *IFRS for SMEs* as a transition standard. While the *IFRS for SMEs* may be useful for other entities, they were not the main reason for developing the *IFRS for SMEs.*

24. The *IFRS for SMEs* was simplified from full IFRSs for entities without public accountability on the basis of users' needs and cost-benefit analyses. Consequently, in most circumstances, the staff do not think the *IFRS for SMEs* is suitable for the needs of users of publicly accountable entities. Therefore, the staff

recommends that the IASB provides guidance to local authorities/standard-setters that sets out:

(a) the intended scope of the *IFRS for SMEs* and why it is generally not appropriate for entities with public accountability;

(b) the IASB's reasoning for deleting or replacing paragraph 1.5;

(c) factors to consider when assessing whether a publicly accountable entity has similar characteristics to entities without public accountability;

(d) how financial information will be affected by moving to the *IFRS for SMEs* (ie highlight the main differences between the *IFRS for SMEs* and full IFRSs); and

(e) further guidance on how to apply the term 'fiduciary'.

25. If the suggested guidance in paragraph 24(a)-(e) is provided to inform local authorities/standard-setters, the staff does not think intended scope or the term publicly accountability need to be modified. The guidance could be provided in the Preface to the *IFRS for SMEs* or in the Basis for Conclusions accompanying the amendments to the *IFRS for SMEs*. However the staff think it may also need to be broadcast more widely at the time the *IFRS for SMEs* is updated.

26. At the March 2013 IASB meeting several IASB members indicated support for replacing paragraph 1.5 with a disclosure requirement for publicly accountable entities. The staff propose the following wording:

1.5 If a publicly accountable entity uses the IFRS for SMEs, it shall disclose the following:

(a) the fact that it has public accountability as defined in the *IFRS for SMEs*; and

(b) the reason why the entity has chosen to apply the *IFRS for SMEs*, including why this provides sufficient information for users of its financial statements.

27. The following is an illustration of how this disclosure could be provided:

Note X Basis of preparation
These consolidated financial statements have been prepared in accordance with the *IFRS for SMEs.*
Company XYZ is not traded on a formal exchange. However, Company XYZ meets the definition of public accountability in the *IFRS for SMEs* because its ordinary shares are traded via broker-dealers. The shares in Company ZYZ are held by a limited group of investors who participate in significant business decisions. Therefore, the management of Company XYZ believe that the *IFRS for SMEs* provides sufficient information to meet their needs.

Questions for the IASB
1) Does the IASB agree with the staff recommendation that paragraph 1.5 of the *IFRS for SMEs* should be deleted and replaced with the disclosure requirement set out in paragraph 26? **2) Does the IASB agree with the staff recommendation that the *IFRS for SMEs* should remain clear that its intended scope is entities that do not have public accountability (as defined) and its requirements should not be amended to cater for publicly traded entities or entities holding assets for a broad group of outsiders as one of their primary businesses?** **3) Does the IASB agree with the staff recommendation that additional guidance should be provided to jurisdictions as set out in paragraph 24?**