

## STAFF PAPER

October 2014

## IASB Meeting

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

**Objective of this meeting**

1. The purpose of this meeting is for the IASB to begin to discuss the issues raised by respondents to ED/2013/9 *Proposed amendments to the IFRS for SMEs* (the ED) and decide whether to make changes to the proposals in the ED to address those issues.
2. At this meeting the staff will ask the IASB to consider the issues raised about the scope of the *IFRS for SMEs*, accounting policy options, and new and revised IFRSs.

**Summary of agenda papers**

3. The staff have prepared the following papers for this meeting:
  - **IASB Agenda Paper 5 Cover paper** (this paper). This paper provides an overview of the comprehensive review of the *IFRS for SMEs* so far, an update on progress on the report of the SME Implementation Group (SMEIG), details of user outreach and an estimated timetable for the rest of the comprehensive review process.

- **IASB Agenda Paper 5A Scope, accounting policy options, and new and revised IFRSs.** Agenda Paper 5A summarises the main feedback received in comment letters on the ED, provides the SMEIG and staff recommendations, and asks questions to the IASB.

## Overview of the comprehensive review

4. 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* had been published by a broad range of entities.
5. Steps taken so far:
  - (a) June 2012: The IASB issued a Request for Information (RfI) seeking public views on whether there is a need to make any amendments to the *IFRS for SMEs*. Comment deadline was November 2012.
  - (b) February 2013: The SMEIG met to discuss comments and develop recommendations for the IASB on possible amendments to the *IFRS for SMEs*.
  - (c) March to June 2013: IASB deliberations on possible amendments to the *IFRS for SMEs*.
  - (d) October 2013: ED issued. Comment deadline was March 2014.
  - (e) May 2014: Comment letter analysis presented to the IASB.
  - (f) July–September 2014: The SMEIG<sup>1</sup> considered the public responses received on the ED and developed draft recommendations for the IASB.

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<sup>1</sup> On 30 June 2014, the second term of the 22 existing members of the SMEIG (that developed recommendations for the IASB in February 2013) came to an end. From 1 July 2014 the SMEIG consists of 11 of those existing members and 16 new members.

## **SMEIG Report**

6. A draft report containing the recommendations of the SMEIG on the proposals in the ED has been prepared and is awaiting final approval by the SMEIG. It is expected to be posted to the SME webpages of the IASB website later this month (October 2014).
7. The process for developing the SMEIG report was as follows:
  - (a) SMEIG members were asked to consider three staff papers (SMEIG Agenda Papers 1-3). Those papers summarised the feedback from respondents to the ED and provided initial staff recommendations for how to address that feedback. SMEIG members were asked to respond to a number of questions by email. SMEIG Agenda Papers 1-3 are available online: <http://www.ifrs.org/Alerts/SME/Pages/SME-Implementation-Group-papers-available-online-July-2014.aspx>.
  - (b) All original responses from SMEIG members on the questions in SMEIG Agenda Papers 1-3 were posted to the SMEIG pages on the SharePoint database. All SMEIG members have access to that database and can access each other's responses.
  - (c) The staff used individual SMEIG member's responses to develop the first draft of a report containing a combined response by the SMEIG on those questions. The objective of this combined response is to summarise the main comments made by SMEIG members. Due to the number of different comments received, the report will not include suggestions made by only one or two SMEIG member(s) unless the staff judge that they warrant inclusion by their nature.
  - (d) The first draft of the report was circulated to SMEIG members for their review and comment.
  - (e) At the date of posting this agenda paper, the staff had prepared a second draft of the report incorporating the comments made by SMEIG members on the first draft. The second draft will be circulated to

SMEIG members asking if they have any further comments and also asking for their approval of the report.

(f) Once the report has been approved by the SMEIG it will be posted on the IASB website.

8. There were no significant comments made by SMEIG members on the first draft of the report relating to the three issues in Agenda Paper 5A. For this reason, the staff do not envisage that there will be further changes to the recommendations in the SMEIG report for these issues. The staff are therefore satisfied that the IASB can proceed with their discussions on the three issues in Agenda Paper 5A supported by the SMEIG recommendations as set out in the second draft of the report (near-final draft). A verbal update on any changes to the recommendations will be provided at the IASB meeting.

### **Ongoing user outreach**

9. At the May 2014 IASB meeting the staff said it will provide the IASB with a summary of its user outreach before the IASB commences its main redeliberations of the proposals in the ED. The staff have included this summary in the appendix to this agenda paper. This will also be posted as a separate document on the IASB website.

## Timetable

10. The staff anticipate the following timetable for the remainder of the comprehensive review:

October – December 2014	The IASB considers responses to the ED and the SMEIG recommendations, and redeliberates on the proposals in the ED.
First quarter of 2015	The IASB issues final amendments to the <i>IFRS for SMEs</i> . Expected effective date 1 January 2017 with early application permitted.

## Appendix: User outreach

### Purpose of this appendix

- A1. This appendix gives an overview of the user outreach performed by the staff and summarises the feedback received.

### Introduction

- A2. The IASB did not receive any comment letters on the ED from investors, providers of credit or other users of financial statements. Additionally, the IASB only received two comment letters from users of financial statements (a ratings agency<sup>2</sup> and a user representation body<sup>3</sup>) on the RfI. A limited response from users of financial statements is common on IASB consultation documents and was particularly expected during the comprehensive review of the IFRS for SMEs because the range of users of the financial statements of entities without public accountability is narrower than those of entities with public accountability. Consequently, the staff performed additional user outreach to supplement the views it has received from other interested parties on the SME consultation documents.
- A3. During March–May 2014 the staff held six conference calls with organisations that provide credit to SMEs. This is considered by the staff to be the primary external user group of SME financial statements. Paragraphs A8–A9 of this appendix provide a staff summary of the main comments made by these participants. The staff also had a conference call with the ratings agency that submitted the comment letter on the RfI in order to understand the views in the comment letter in more detail. Most of the calls were attended by several participants from multiple jurisdictions. The outreach covered organisations providing credit to SMEs in Europe, Asia, Africa and Australia.

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<sup>2</sup> Standard & Poor's Ratings Services

<sup>3</sup> International Association of Consultants, Valuers and Analysts (IACVA)

## Difficulties encountered

- A4. The staff had hoped to extend this outreach further to cover other jurisdictions where the *IFRS for SMEs* or a similar Standard is being applied extensively by SMEs. However the staff encountered difficulties in identifying additional users of SME financial statements who are also familiar with the *IFRS for SMEs* or similar Standards. The staff think this is due to three main reasons:
- (a) As noted above the range of users of SME financial statements is narrower than those of publicly accountable entities. Often investors in SMEs are closely involved in management of the entity, meaning that the primary user group of SME general purpose financial statements is generally providers of credit.
  - (b) Many providers of credit to SMEs are small, local entities with limited resources, and often they do not speak fluent English. Therefore they are difficult for staff to locate and contact and/or are uncomfortable in participating in even informal discussions.
  - (c) The *IFRS for SMEs* is a new Standard. Consequently many providers of credit have had limited experience with SMEs using the *IFRS for SMEs*.

## Future considerations

- A5. Most of the feedback received during the user outreach conducted was consistent between the participants and did not highlight any new issues that are connected to, or may be affected by, the proposals in the ED. This was expected by the staff because the ED does not propose any significant changes to the requirements in the *IFRS for SMEs*. Consequently, the staff do not think that further user outreach on the proposals in the ED is necessary in order to finalise those proposed changes, unless significant changes are made to these proposals during redeliberations.
- A6. Nevertheless, the staff note that some of the participants provided general suggestions for how SMEs may be able to improve information provided in their

financial statements. The staff would like to explore these suggestions further and obtain additional user input once more users become familiar with the *IFRS for SMEs*, as the Standard becomes more extensively applied worldwide. Consequently the staff think that the IASB and the SMEIG should consider how best to obtain more user involvement in advance of the next review of the *IFRS for SMEs*.

### **Focus of the conference calls**

- A7. The participants in the outreach were generally not very familiar with the detailed requirements in the *IFRS for SMEs*. Furthermore, some of the participants only had a limited number of clients that use the *IFRS for SMEs*. Consequently, rather than focus on specific requirements in the Standard or the ED, the staff decided that the aim of the user outreach should be to obtain general feedback from the participants on how they use the financial information provided by SMEs and how they think that financial information could be improved. The staff asked questions in the following areas:
- (a) The process they use when evaluating SME clients for providing credit, including whether/ how they use the information in SME financial statements.
  - (b) The degree of importance placed on assurance (eg audit reports).
  - (c) Additional information they have requested that is not in the financial statements.

### **Summary of the main comments received by the six participants**

- A8. As noted in paragraph A6, most of the feedback received during the conference calls was consistent across the six participants interviewed and the jurisdictions they covered. Consequently, based on the similar nature of the activities involved (primarily provision of credit) the staff thinks it is fair to assume that these views are likely to be widespread amongst this type of user and so give the staff a good idea of the views of such users.



A9. The following is a staff summary of the comments that were generally consistently made by the participants about provision of credit to SMEs:

- (a) For very small lines of credit, participants often do not require financial statements. They make their judgement based on their knowledge of the entity, shareholder or owner support, bank statements, meetings with management, available credit ratings, and knowledge about the market.
- (b) For lines of credit, other than those in (a), these participants generally use the numbers in the SME's primary financial statements (ie the balance sheet, profit or loss account and cash flow statement) to develop an initial rating using in-house models. They then apply judgement, incorporating other available information such as that outlined in subparagraph (a) above, in deciding whether to provide credit.
- (c) Participants do not generally require detailed financial information at the same level for small lines of credit as they would for larger lines of credit. Furthermore, they generally rely on the financial information as provided in SME financial statements, ie they do not request additional historical financial information or make any adjustments to the financial information in the financial statements. However some may request additional forward looking information, eg management budgets or forecasts.
- (d) Participants place a high regard on financial statements that have been audited and this improves the SME's initial rating.
- (e) For small lines of credit, ability to service debt/cash generation is key, rather than profitability. The main concern of the participants was whether the SME can cover the repayments of the finance.
- (f) Some participants noted that they prefer fewer accounting choices because it leads to more consistent accounting and comparison across companies.
- (g) Common comments on the detail in the financial statements for SMEs:

- (i) Most participants spend limited time analysing the notes to the financial statements, in comparison to larger lines of credit. However, some noted that disclosures about working capital and liquidity are important to assess cash generation, eg information about debtor and creditor breakdowns and aging, inventory days and breakdown, debt maturity analysis and major terms of debt. Some noted that some SMEs do not give this detailed information in their financial statements.
- (ii) Participants generally do not request information about the fair values/market values of property, plant and equipment (PPE) held at cost, unless the SME has significant property holdings. Some noted that they prefer PPE to be at cost for use in developing their initial rating for consistency with other entities and for better understanding of the drivers of value in the entity. One participant noted that if they knew the PPE had a high market value this would not improve the initial rating, but may give them some comfort when judging whether to provide credit.
- (iii) Participants generally said that receiving a cash flow statement is useful. If an entity does not produce a cash flow statement, participants generate one using their models. However, generating a statement of cash flows themselves is not ideal because some information may not be available meaning there will be unknown values in the statement.
- (iv) Some participants noted that their in-house models used to determine the initial ratings are risk weighted, eg intangible assets are not worth as much as tangible assets. For example a company with high percentage of assets as goodwill (eg 50%) would get a lower rating.