Agenda ref	**5A**

STAFF PAPER

October 2014

IASB Meeting

Project	**Comprehensive review of the *IFRS for SMEs***		
Paper topic	Scope, accounting policy options, and new and revised IFRSs		
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Objective of this meeting

1. This agenda paper covers the comments made by respondents to ED/2013/9 *Proposed amendments to the IFRS for SMEs* (the ED) in three key areas— scope of the *IFRS for SMEs*, accounting policy options, and new and revised IFRSs.

2. The staff would like the IASB to discuss these comments and decide whether to make any changes to the proposals in the ED to respond to these comments.

Structure of this paper

3. This agenda paper is set out as follows:

   (a) Introduction

   (b) Organisation of the issues

   (c) Issue 1: Scope of the *IFRS for SMEs*

   (d) Issue 2: Accounting policy options

   (e) Issue 3: New and revised IFRSs

4. Appendix: Extracts from the comment letter analysis on the 2012 Request for Information (RfI) – comments on accounting policy options

Introduction

5. The staff have chosen to address the three issues in this paper first because the issue are broad, are likely to take the most IASB time to discuss, and the staff think that the IASB's decisions on these issues could affect the IASB's discussion on the other issues raised by respondents to the ED.

6. The other issues raised by respondents generally relate to specific requirements in the *IFRS for SMEs* and will be discussed at the next IASB meeting.

Organisation of the issues

7. The three issues in this paper are set out as follows:

   (a) Introduction to the issue

   (b) Summary of the main feedback received in comment letters on the ED. This has been taken from Agenda Paper 15A from the May 2014 IASB meeting.

   (c) Feedback from the June 2013 IFRS Advisory Council meeting, where applicable.

   (d) Staff analysis of the feedback received in comment letters on the ED.

   (e) Staff recommendation. The staff recommendation provides the initial views of the staff on how to address the feedback received.

   (f) SMEIG recommendation. Taken from the near-final draft of the report of recommendations of the SME Implementation Group (SMEIG).

   (g) Question for the IASB to respond to.

Issue 1) Scope of the *IFRS for SMEs*

Introduction

8. The *IFRS for SMEs* is intended for use by entities that do not have public accountability. An entity is considered to have public accountability if its debt or

equity instruments are traded, or in the process of being issued for trading, in a public market, or it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (paragraph 1.3 of the *IFRS for SMEs)*.

9. Publicly accountable entities are not permitted to state compliance with the *IFRS for SMEs* (paragraph 1.5 of the *IFRS for SMEs*).

10. The RfI asked whether some or all publicly accountable entities should be permitted to apply the *IFRS for SMEs*. The IASB considered the responses to the RfI together with the IASB's original reasons for restricting the scope to entities without public accountability in the *IFRS for SMEs* and decided not to propose changes to the intended scope of the *IFRS for SMEs* or to paragraph 1.5. The IASB's reasoning is provided in paragraphs BC17-BC21 of the ED.

11. In the ED the IASB also clarified that its 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 and that typically have less complex transactions, limited resources to apply full IFRSs and that operate in circumstances in which comparability with their publicly accountable peers is not an important consideration (paragraph BC29 of the ED).

Feedback from respondents to the ED

12. Although the ED did not ask a question on the overall scope of the *IFRS for SMEs*, a significant minority of respondents had comments, most of which they had also raised on the RfI. The following is a summary of the main issues raised by respondents:

    (a) **Do not restrict the scope**. Legislative and regulatory authorities and standard-setters in individual jurisdictions are in the best position to decide which entities should be required or permitted to use the *IFRS for SMEs*. Remove paragraph 1.5 that prohibits publicly accountable entities from stating compliance with the *IFRS for SMEs*.

    (b) **Concern about the focus of the *IFRS for SMEs***. There appears to be a discrepancy between the stated scope 'entities that do not have public accountability' and the IASB's primary aim when developing the *IFRS for SMEs* in paragraph BC29 in the ED —'to provide a standalone, simplified set of accounting principles for entities that do not have public accountability and that typically have less complex transactions, limited resources to apply full IFRSs and that operate in circumstances in which comparability with their listed peers is not an important consideration'. The IASB's primary aim suggests a focus on relatively small, simple SMEs. However, if the IASB focuses only on these kinds of SME, the reporting needs of many non-publicly accountable entities will not be effectively addressed. Consequently, the IASB may be limiting the ability of jurisdictions to adopt the *IFRS for SMEs*, in particular those with more advanced financial reporting and regulatory frameworks and where large and complex entities fall in the scope.

(c) **Better identify the needs of users of SME financial statements**. The objective of financial statements in paragraph 2.2 of the *IFRS for SMEs* describes users and their needs in a very similar way to full IFRSs. Consequently, it is hard to understand the conceptual basis for differences from full IFRSs. The IASB should more clearly describe the underlying assumptions for developing the *IFRS for SMEs* in the context of preparers and users. This should include explaining why the *IFRS for SMEs* is not suitable for publicly accountable entities. If cost-benefit is a major driver of the difference from full IFRSs, public accountability is not an appropriate criterion.

(d) ***IFRS for SMEs* is still too complex**. Many entities without public accountability are small owner managed entities. (Respondents from Asia)

(e) **Exclude credit unions from the definition of 'publicly accountable'**. Some credit unions, especially smaller institutions and those in developing countries, should be able to state conformity with the *IFRS for SMEs* to limit excessive compliance burdens. Adherence to an international Standard like the *IFRS for SMEs*, scaled to the small size and limited complexity of these financial institutions, has the potential to improve significantly the usefulness of financial reports.

Feedback from the IFRS Advisory Council meeting in June 2013

13. A majority of IFRS Advisory Council members favoured keeping the requirement in paragraph 1.5 of the *IFRS for SMEs* that prevents publicly accountable entities from stating compliance with the *IFRS for SMEs*.

Staff analysis of the feedback on the ED

The scope of the IFRS for SMEs

14. The staff support the IASB's reasoning in paragraphs BC17-BC21 in the ED. The IASB has discussed at length whether publicly accountable entities should be able to use and state compliance with the *IFRS for SMEs*, both during development of the *IFRS for SMEs* and when considering the responses to the RfI. After considering the responses to the ED the staff do not think that there is sufficient new information to reconsider the IASB's previous decision.

The primary aim in developing the IFRS for SMEs

15. Some respondents expressed concern that the IASB's primary aim in developing the *IFRS for SMEs* in paragraph BC29 in the ED means the reporting needs of 'large', complex non-publicly accountable entities are not effectively addressed (paragraph 12(b)). However, other respondents had concerns that the *IFRS for SMEs* is still too complex for 'small', simple SMEs (paragraph 12(d)). Such contrasting views have been evident throughout the development of the *IFRS for SMEs* and show the challenge the IASB faces in determining the content of the *IFRS for SMEs*.

16. The *IFRS for SMEs* is intended for all SMEs, defined to be those entities that do not have public accountability, regardless of size or complexity, that are required, or elect, to publish general purpose financial statements for external users. The IASB's reasons for developing a Standard intended for all SMEs are explained in the Basis for Conclusions accompanying the *IFRS for SMEs* (paragraphs BC55-

BC77). Nevertheless, when deciding on the content of the *IFRS for SMEs*, the primary aim of the IASB was to include the kinds of transactions, events and conditions encountered by typical SMEs that are likely to apply the *IFRS for SMEs.* If the IASB had tried to cater for all possible transactions that SMEs may enter into, the *IFRS for SMEs* would have had to retain most of the content of full IFRSs. In particular, the IASB was mindful that many SMEs have limited resources, and that the Standard should accommodate that limitation. Conversely, entities including SMEs, with more complex transactions and activities are likely to have more sophisticated systems and greater resources to manage those transactions. If an SME has very complex transactions or determines that comparability with its publicly accountable peers is of key importance to its business, the staff would expect that the entity would want to, and have sufficient expertise, to either refer to the more detailed guidance on complex transactions in full IFRSs (see paragraph 10.6 of the *IFRS for SMEs*) or apply full IFRSs rather than the *IFRS for SMEs*. The staff think the primary aim is already clear in the *IFRS for SMEs*. However the staff think it is useful to re-emphasise the primary aim during this comprehensive review because it is helpful in showing how the IASB achieved a suitable balance in deciding on the content of the *IFRS for SMEs*.

Differences between the IFRS for SMEs and full IFRSs

17. Some respondents said they found it difficult to understand the conceptual basis for differences between the *IFRS for SMEs* and full IFRSs. Some said the IASB should more clearly describe the underlying assumptions for developing the *IFRS for SMEs* in the context of preparers and users (paragraph 12(c)). The staff think the Basis for Conclusions accompanying the *IFRS for SMEs* is clear on both of these points. In particular:

    (a) paragraph BC95(a) notes that the *IFRS for SMEs* was developed by considering the modifications that are appropriate to full IFRSs in the light of users' needs and cost-benefit considerations.

    (b) paragraphs BC44-BC47 and BC157 are the main paragraphs describing the needs of users of SME financial statements and explaining how they differ from the needs of users of financial statements of publicly accountable entities.

18. Some respondents said that if cost-benefit considerations are a major driver of the differences between the *IFRS for SMEs* and full IFRSs, public accountability is not an appropriate criterion (paragraph 12(c)). The staff agree that the related costs of publicly and non-publicly accountable entities may not differ significantly. However, the staff note that the 'benefits' side of the cost-benefit trade-off considers the different information needs of different financial statement users. Consequently, during development of the *IFRS for SMEs*, the IASB assessed the cost-benefit trade-off in the *IFRS for SMEs* in relation to the information needs of the users of SME financial statements. The IASB's reasoning is explained more fully in in the Basis for Conclusions accompanying the *IFRS for SMEs* (paragraphs BC44-BC47). The staff continue to support this reasoning.

Staff recommendation

19. The staff recommend no changes to either the scope of the *IFRS for SMEs* or to the IASB's primary aim, or its articulation thereof, when developing the *IFRS for SMEs*.

SMEIG view on staff recommendation

The majority of SMEIG members supported the staff recommendation without modification.

However a few[1] SMEIG members said that authorities in individual jurisdictions are best placed to decide which entities should be permitted or required to apply the *IFRS for SMEs*. These SMEIG members supported deleting paragraph 1.5 of the *IFRS for SMEs* which prohibits publicly accountable entities from stating compliance with the *IFRS for SMEs*.

[1] Where reference is made to 'a few SMEIG members', this signifies 5 or less of the 27 members.

A few SMEIG members also noted that the scope restriction in paragraph 1.5 is likely to be a barrier to the adoption of the *IFRS for SMEs* in some jurisdictions.

Question for the IASB
1) Do you agree with the staff recommendation?

Issue 2) Accounting policy options

Introduction

20. The RfI asked whether SMEs should be permitted to use a revaluation model for property, plant and equipment (PPE), and either permitted or required to capitalise borrowing and development costs meeting criteria similar to that in full IFRSs. The IASB considered the responses to the RfI together with the IASB's original reasons for excluding these three accounting policy options in the *IFRS for SMEs* and decided not to propose any changes to incorporate these options. The IASB's reasoning is in paragraphs BC39-BC48 of the ED.

Feedback from respondents to the ED

21. Although the ED did not ask specific questions on accounting policy options, a significant minority of respondents said that the IASB should reconsider its decision on accounting policy options. This was the most common concern raised by respondents to the ED. Most of these respondents asked the IASB to include an option for SMEs to revalue their PPE. However, a significant number also asked the IASB to permit SMEs to capitalise borrowing and/or development costs meeting certain criteria. Nevertheless, a significant number of respondents stated their agreement with the IASB's decision not to add additional complex accounting policies in the ED.

22. Respondents provided many different reasons for and against additional accounting policy choices. Many of these reasons were raised in response to the specific questions in the RfI, and were covered in the comment letter analysis on

the RfI (relevant extracts are included in the appendix to this paper). The staff have not repeated those comments in the body of this agenda paper. However, a few respondents raised further arguments, ie not raised on the RfI, and therefore not previously considered by the IASB. These are summarised in paragraphs 23-24 below.

23. Respondents in support of including accounting policy options noted that:

(a) The requirements for accounting for deferred tax under Section 29 *Income Tax* make the *IFRS for SMEs* more complex than would the inclusion of the additional accounting policy options. Furthermore, SMEs can always choose to apply the simpler option, whereas Section 29 is mandatory for all SMEs.

(b) A Standard that does not allow these options is only suitable for simple entities with relatively basic needs and jurisdictions that do not have a well-established financial reporting background. If the IASB does not permit these options, jurisdictions will need to amend the *IFRS for SMEs* to meet their needs, reducing comparability between SMEs across borders.

24. Respondents who commented against including additional accounting policy options noted that:

(a) It is best to have a simple, core Standard that jurisdictions can either:

(i) adopt in its current form— eg in jurisdictions where options would be an unnecessary complexity; or

(ii) use as a starting point and add to it if they deem necessary. It is inevitable jurisdictions will make changes to the Standard to reflect issues specific to them. It would be impossible to cater for all of these jurisdictional requirements in a simple Standard.

(b) Adding options increases the complexity of the Standard and may dissuade small/less developed jurisdictions (which have the most to benefit from the *IFRS for SMEs*) from adopting it. In situations where those jurisdictions have adopted the Standard, it could lead them to revert to their previous local GAAP.

Staff analysis of the feedback on the ED

25. The staff support the IASB's reasoning in paragraphs BC39-BC48 of the ED. The IASB has discussed these three accounting policy options/requirements at length, both during development of the *IFRS for SMEs* and when considering the responses to the RfI. After considering the responses to the ED the staff do not think that there is sufficient new information to reconsider the IASB's previous decisions.

26. **Note:** Staff have included all three of these accounting policies together because many comment letters propose that SMEs are given an <u>option</u> to follow the full IFRSs requirements for capitalisation of borrowing costs and development costs. However it is worth emphasising there is a difference in the way that the IASB should consider these three accounting policies:

    (a) **Revaluation of PPE:** The *IFRS for SMEs* requires the cost model for PPE. Full IFRSs permits either the cost model or the revaluation model for PPE. Therefore the difference between full IFRSs and the *IFRS for* SMEs is the *IFRS for SMEs* removes an option under IFRSs.

    (b) **Borrowing and development costs:** The *IFRS for SMEs* requires expensing of borrowing and development costs. Full IFRSs requires capitalisation of borrowing and development costs meeting certain criteria, otherwise they are expensed. Therefore the difference between full IFRSs and the *IFRS for SMEs* is a difference in the basis of accounting for these costs. The *IFRS for SMEs* simplifies the requirements. It does not remove an option.

Staff recommendation

27. The staff recommend no changes are made to the *IFRS for SMEs,* ie the staff do not recommend permitting a revaluation model for PPE and do not recommend

permitting or requiring capitalisation of borrowing or development costs meeting criteria similar to that in full IFRSs.

SMEIG view on staff recommendation

Slightly more than half of SMEIG members supported the staff recommendation without modification. However, a few of these noted that they actually supported permitting these three accounting treatments as options (ie revaluation of PPE, capitalisation of borrowing costs and capitalisation of development costs), but noted that the IASB has made a decision and that it should not delay the current review of the *IFRS for SMEs* by reconsidering these options again.

Nearly half of SMEIG members disagreed with not permitting one or more of the three accounting treatments as options. The following were the main reasons given:

- Authorities in individual jurisdictions are in the best position to decide whether to permit or restrict use of these options.
- Not allowing these three accounting treatments is causing many entities and jurisdictions to reject the *IFRS for SMEs.*
- Many SME preparers want these options. Allowing options does not increase complexity for other SMEs because they are able to choose the simpler option.
- For many entities these options would best reflect their financial position and performance, and provide better information for users of their financial statements. For example the revaluation model is important for entities with significant assets whose value differs from cost, eg those operating in high inflationary economies or holding significant real estate; the option to capitalise development costs is important for start-up entities; and the option to capitalise borrowing costs is important for entities with significant borrowing costs, eg property development entities.

Question for the IASB

2) Do you agree with the staff recommendation?

Issue 3) Alignment with full IFRSs

28. The *IFRS for SMEs* was developed using full IFRSs as a starting point and considering what modifications are appropriate in the light of users' needs and cost-benefits. Consequently, one of the most significant issues the IASB needed to address during this comprehensive review was whether the *IFRS for SMEs* should be updated for new and revised IFRSs published since the *IFRS for SMEs* was issued in 2009.

29. The RfI included questions on the five new or revised IFRSs that had the potential to result in the most significant changes to the *IFRS for SMEs*, namely IFRS 3 (2008) *Business Combinations*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 13 *Fair Value Measurement* and IAS 19 (2011) *Employee Benefits*. During redeliberations the IASB considered the responses to the RfI, the primary aim of the *IFRS for SMEs* (paragraph 11) and the enhanced need for stability in the early years of use of the Standard. Based on these redeliberations the IASB decided not to propose to incorporate IFRS 3 (2008), 10, 11 and 13, and IAS 19 (2011). The IASB's full reasoning is in paragraphs BC33-BC38 in the ED. During these redeliberations the IASB also developed the following principles for dealing with new and revised IFRSs when developing the ED and during future reviews of the *IFRS for SMEs*:

    (a) Each new and revised IFRS, including annual improvements, should be considered individually on a case-by-case basis.

    (b) New and revised IFRSs should not be considered before they have been published. However, it would generally not be necessary to wait until their Post-implementation Reviews (PIRs) have been completed.

    (c) Changes to the *IFRS for SMEs* could be considered at the same time that new and revised IFRSs are published. However, the *IFRS for SMEs* would only be updated for those changes at the next review to provide a stable platform for SMEs.

    The IASB further observed that, when applying these principles, decisions both on which changes to incorporate into the *IFRS for SMEs* and the appropriate timing for incorporating those changes should be weighed against the need to provide SMEs with a stable platform and the suitability of such changes for SMEs and users of their financial statements. The IASB noted that it may decide only to incorporate changes from a complex new or revised IFRS after implementation experience of that IFRS has been assessed. However, it will make this assessment when new or revised IFRSs are published rather than automatically waiting until a PIR has taken place.

30. Because the RfI had previously solicited feedback about the main changes to full IFRSs since 2009, the ED only specifically asked questions about the changes resulting from new and revised IFRSs that were proposed in the ED.

Feedback from respondents to the ED

31. Most respondents to the ED had general comments on the IASB's approach for dealing with new and revised IFRSs. The following is a summary of the main issues raised by respondents:

    (a) **Establish better criteria for assessing changes to full IFRSs**. Some respondents said the IASB should establish a formal framework or clearer principles to determine whether and when changes to full IFRSs should be incorporated in the *IFRS for SMEs*. Respondents asserted that if a clear framework is established, changes can be better evaluated. These respondents noted that the principles developed by the IASB (paragraph 29) are not clear enough to achieve this. Some respondents provided suggestions to replace those principles. Some respondents said it was not clear why the IASB was proposing to include some but not other new and revised IFRSs during this review. Examples given:

        (i) Some changes to full IFRSs that would improve or simplify requirements in the *IFRS for SMEs* have not been incorporated (eg the basis of the calculation of net interest under IAS 19) while others of limited value have been (eg the recent amendments to IAS 1 to group items in other comprehensive income (OCI)).

(ii) The proposed amendment to group items in OCI is inconsistent with the IASB's decision not to reconsider the use of OCI in the *IFRS for SMEs*.

(b) **Incorporate IAS 19 (2011).** Apart from those supporters of general close alignment with full IFRSs (see paragraph 31(d) below), very few respondents had specific comments on the IASB's decision not to incorporate IFRS 3 (2008), 10, 11 and 13. In contrast, several respondents said that the IASB should reconsider its decision not to incorporation the main changes under IAS 19 (2011) during this comprehensive review. Respondents asserted that many of these changes would simplify the requirements in the *IFRS for SMEs* whist at the same time enhancing consistency with full IFRSs.

(c) **Wait until sufficient implementation experience/PIRs complete**. Some respondents said the suitability of a significant new or revised IFRS should only be assessed once a track record of its application under full IFRSs has been established and interpretation issues have been resolved. Respondents asserted this would enhance stability and minimise changes to the *IFRS for SMEs*. Most of these respondents said this would generally be once a PIR has been completed.

(d) **More closely align the recognition and measurement requirements with full IFRSs**. Some respondents said all recent changes to full IFRSs should be incorporated in the *IFRS for SMEs* at each three-yearly review of the *IFRS for SMEs*, subject to the principles underlying the *IFRS for SMEs* (ie cost-benefits and user needs). Consequently these respondents supported incorporation of changes under IFRS 3 (2008), 10, 11, 12 and 13 and IAS 19 (2011) during this comprehensive review. These respondents were concerned that delaying incorporation of changes to full IFRSs would result in too large a gap between the *IFRS for SMEs* and full IFRSs and that this would make the *IFRS for SMEs* less attractive to entities. Some respondents highlighted the importance of the IASB explaining clearly its reasoning in any areas where the IASB decides not to align *IFRS for SMEs* with full IFRSs.

Feedback from the IFRS Advisory Council meeting in June 2013

32. A majority of IFRS Advisory Council members favoured prioritising the need to provide SMEs with a stable, independent and standalone Standard over maintaining close alignment with full IFRSs.

Staff analysis of the feedback on the ED

Criteria for assessing changes to full IFRSs

33. Some respondents said the IASB should establish clearer principles/framework to determine whether and when changes to full IFRSs should be incorporated in the *IFRS for SMEs* (paragraph 31(a)). Some respondents said the suitability of a significant new or revised IFRS should only be assessed once a track record of its application under full IFRSs has been established and interpretation issues have been resolved. Some said this would generally be once a PIR has been completed (paragraph 31(c)). However, other respondents said all recent changes to full IFRSs should be incorporated in the *IFRS for SMEs* at each three-yearly review to maintain close alignment with full IFRSs (paragraph 31(d)). Such contrasting views have been evident throughout the development of the *IFRS for SMEs* and show the challenge the IASB faces in determining the content of the *IFRS for SMEs*.

34. The staff suggests the IASB considers the comments in paragraph 33 more generally at a future meeting. The staff note that there are special considerations applicable to this initial review of the Standard, which led the board to place greater emphasis on the need for limiting changes. The staff think that the SMEIG and IASB should discuss and consider to what extent such a framework for future reviews of the *IFRS for SMEs* can be developed after this comprehensive review has been completed. This will allow more time for discussion and enable IASB and SMEIG members to reflect on the lessons learnt during this initial comprehensive review.

35. Some respondents said it was not clear why the IASB was proposing to include some but not other new and revised IFRSs during this review. Specific examples given by respondents are in paragraph 31(a)(i)-(ii). The staff think that the IASB's

reasoning in paragraphs BC33-BC38 in the ED is clear and appropriate in light of the greater need for stability during this initial comprehensive review than in future reviews. In particular, the new and revised IFRSs proposed to be incorporated during this review would only make minor changes to the *IFRS for SMEs.* In addition, for these minor changes, SMEs would not be expected to benefit much from waiting for implementation guidance/experience to be developed under full IFRSs. Consequently, there is little benefit in waiting until a future review before incorporating them. The staff think that these reasons support the IASB's decision not to propose to incorporate some of the more significant changes to full IFRSs, eg changes to IAS 19 (paragraph 31(a)(i)) and changes to the use of OCI (paragraph 31(a)(ii)), even though minor changes that may seem to address a similar area, eg presentation of items in OCI, have been proposed.

IAS 19 (2011) Employee Benefits

36. Several respondents said that the IASB should reconsider its decision not to incorporate the main changes under IAS 19 (paragraph 31(b)). The staff disagree and support the IASB's reasoning for not doing so in paragraphs BC33-BC34 in the ED.

37. The new and revised IFRSs proposed to be incorporated during this review would only make minimal changes to the *IFRS for SMEs*. This would not be the case for IAS 19 (2011). Furthermore the staff do not think it would be appropriate to incorporate only one or two of the changes made by IAS 19 (2011), eg those that might provide a simplification for SMEs such as the basis of the calculation of net interest, without considering the other changes. Section 28 *Employee Benefits* is currently based on IAS 19 before it was amended in 2011. The staff think incorporating only one or two of the requirements of IAS 19 (2011) risks developing a mixed model of old and new IAS 19 for employee benefits. The staff think this could lead to confusion and result in inconsistencies in the *IFRS for SMEs*.

New and revised IFRSs issued since the ED was published

38. One of the IASB's principles for dealing with new and revised IFRSs during reviews of the *IFRS for SMEs* is that they should not be considered until they have

been published. This is because, until a final IFRS is issued, the IASB's views are tentative and occasionally principles in a final IFRS may differ significantly from those proposed in an Exposure Draft (paragraph BC30(b)) and BC32 of the ED). Consequently, the following new and revised IFRSs published in 2013 and 2014 were not considered by the IASB in developing the ED:

(a) September 2014: *Annual Improvements to IFRSs 2012-2014 Cycle*. The staff think the only improvement that may be relevant to current or proposed requirements for SMEs is the amendment to IAS 19 that clarifies that the depth of the market for high quality corporate bonds should be assessed at a currency level for post-employment benefit obligations.

(b) September 2014: *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28)

(c) August 2014: *Equity Method in Separate Financial Statements* (Amendments to IAS 27)

(d) July 2014: IFRS 9 *Financial Instruments*

(e) June 2014: *Agriculture: Bearer Plants* (Amendments to IAS 16 and IAS 41)

(f) May 2014: IFRS 15 *Revenue from Contracts with Customers*

(g) May 2014: *Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to IAS 16 and IAS 38)

(h) May 2014 *Accounting for Acquisitions of Interests in Joint Operations* (Amendments to IFRS 11)

(i) January 2014: IFRS 14 *Regulatory Deferral Accounts*

(j) December 2013: *Annual Improvements to IFRS 2010-2012 Cycle*. The staff think only the following two improvements may be relevant to current or proposed requirements for SMEs:

(i) Amending definitions relating to vesting conditions for share-based payments.

(ii) Amendment to the definition of a related party for a management entity providing key management personnel services.

(k) December 2013: *Defined Benefit Plans: Employee Contributions* (Amendments to IAS 19)

(l) November 2013: *Hedge Accounting* (Amendments to IFRS 9, IFRS 7 and IAS 39)

(m) June 2013: *Novation of Derivatives and Continuation of Hedge Accounting* (Amendments to IAS 39)

(n) May 2013: *Recoverable Amount Disclosure for Non-Financial A*ssets (Amendments to IAS 36)

(o) May 2013: IFRIC 21 *Levis*

39. During reviews of the *IFRS for SMEs*, the staff think the IASB should generally only consider those new and revised IFRSs published after the related Exposure Draft of proposed amendments to the *IFRS for SMEs* has been issued if they respond to an urgent need for SMEs or users of their financial statements. This is because if the IASB makes fundamental changes to the proposals in the ED, on which respondents have not had the opportunity to comment, this would likely result in the need to re-expose the proposals. Furthermore, by the end of the re-exposure period there would be another list of new and revised IFRS to consider.

40. The staff do not think any of the changes under the new or revised IFRS listed in paragraph 38 would respond to an urgent need for SMEs. Consequently, apart from two exceptions, the staff do not suggest that the new and revised IFRS above are considered during this comprehensive review. The two exceptions are the amendment to the definition of a related party for a management entity providing key management personnel services (*Annual Improvements to IFRS 2010-2012 Cycle)* and the August 2014 amendment *Equity Method in Separate Financial Statements* (Amendments to IAS 27)

41. The staff note that the ED proposed to align the definition of a related party with IAS 24 *Related Party Transactions* during this comprehensive review. Consequently the staff also suggest including the minor amendment to the definition in IAS 24 in *Annual Improvements to IFRS 2010-2012 Cycle.*

42. The staff also think that the IASB should incorporate the main change under *Equity Method in Separate Financial Statements* (Amendments to IAS 27), ie permit entities to use the equity method to account for subsidiaries, associates and jointly controlled entities in the separate financial statements, for the following reasons:

    (a) Incorporating this amendment would be consistent with the IASB's criteria for incorporating other new and revised IFRSs during this review (see paragraphs BC33-BC34 and BC36 in the ED). In particular, the amendment would only affect SMEs preparing separate financial statements, it would not require SMEs to change their accounting so would not be burdensome, and it would only require the addition of one sentence to the *IFRS for SMEs*. Consequently the staff think it is consistent with the special need for stability during this initial comprehensive review.

    (b) The *IFRS for SMEs* generally does not include the more complex accounting policy options from full IFRSs (see Issue 2 above). However, this option would only apply in an SME's separate financial statements, not its primary financial statements. The *IFRS for SMEs* does not require presentation of separate financial statements. Consequently the staff think that if SMEs prepare additional financial statements they should be given this extra flexibility.

    (c) The amendment to IAS 27 is effective on 1 January 2016. The amendments to the *IFRS for SMEs* from this comprehensive review are expected to become effective on 1 January 2017. The amendment to IAS 27 does not introduce complex changes that are expected to result in, and benefit from, significant implementation guidance in practice. Consequently the staff think this lead time is sufficient.

Staff recommendation[2]

43. The staff recommend that a subparagraph (ix) is added to the revised definition of a related party in the ED as follows:

> (b) An entity is related to a reporting entity if any of the following conditions applies:
>
> (i) ….
>
> (ix) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

44. The staff recommend that paragraph 9.26 of the *IFRS for SMEs* is amended as follows:

> 9.26 When a parent, an investor in an associate, or a venturer with an interest in a jointly controlled entity prepares separate financial statements and describes them as conforming to the *IFRS for SMEs*, those statements shall comply with all of the requirements of this IFRS. The entity shall adopt a policy of accounting for its investments in subsidiaries, associates and **jointly controlled entities** either:
>
> (a) at cost less impairment, or
>
> (b) at **fair value** with changes in fair value recognised in profit or loss~~.~~,or
>
> (c) using the equity method following the procedures in paragraph 14.8.
>
> The entity shall apply the same accounting policy for all investments in a single class (subsidiaries, associates or jointly controlled entities), but it can elect different policies for different classes.

45. The staff recommend no other changes to the proposals in the ED for new and revised IFRSs, ie the staff recommend that apart from the recommended changes in paragraphs 43-44 only those new and revised IFRSs listed in paragraphs BC35 and BC38 of the ED should be incorporated in the *IFRS for SMEs* during this comprehensive review (as proposed in the ED).

SMEIG view on staff recommendation

(Note: The SMEIG only considered the staff analysis and recommendation for new and revised IFRSs issued prior to publishing of the SMEIG papers in July 2014. Nevertheless, the SMEIG separately considered the staff's recommended amendment to paragraph 9.26 (paragraph 44) and nearly all SMEIG members supported that recommendation.)

The majority of SMEIG members supported the staff recommendation without modification.

[2] New text being proposed is underlined.

However a few SMEIG members expressed concern that significant differences from full IFRSs would make the *IFRS for SMEs* less attractive, eg as a result of differences arising because of long lapses of time before changes to full IFRSs are considered.

A few SMEIG members said that, regardless of the need to provide a stable platform for SMEs, the IASB should incorporate recent changes to full IFRSs if they provide a simplification or would result in significant improvements in financial reporting for SMEs. The recent changes to full IFRSs for accounting for bearer plants was provided as an example by two SMEIG members.

A few SMEIG members said the IASB should clearly state its policy for how it considers changes to full IFRSs during reviews of the *IFRS for SMEs.*

Question for the IASB
3) Do you agree with the staff recommendation?

Appendix: Extracts from the comment letter analysis on the RfI – comments on accounting policy options

A1. These extracts have been taken from Agenda Paper 8D for the April 2013 IASB meeting (paragraphs 5-7 of Agenda Paper 8D covered responses to the RfI on the revaluation model for PPE and paragraphs 13-18 of Agenda Paper 8D covered responses to the RfI on capitalisation of development/borrowing costs).

Revaluation of property, plant and equipment

A2. The following points cover the main reasons given by respondents to the RfI for not adding an accounting policy option to revalue PPE:

(a) There was a lengthy debate on accounting policy options when the *IFRS for SMEs* was being developed. Introducing options makes the *IFRS for SMEs* more complex and reduces comparability between SMEs. Options increase costs for preparers, eg when deciding which option to use and additional costs if they choose the more complex option, and for users as they need to examine the different policies chosen and assess their effects.

(b) The cost model for PPE meets the needs of smaller entities.

(c) If a revaluation model is added, more complex requirements will need to be added in other areas of the *IFRS for SMEs*, eg for deferred taxation and impairment.

(d) SMEs do not need to revalue their PPE to improve access to loan financing. Instead, companies can provide revaluation disclosures in the notes to the financial statements or obtain third party valuations of properties. Regardless of the accounting policy chosen, financial institutions often require a separate valuation to be performed before providing loan finance.

(e) Reliable fair values are often unavailable for items of PPE (this is a bigger issues in developing jurisdictions). Revaluation of PPE in the absence of public information on market values introduces subjectivity and reduce the reliability of financial information.

(f) The fair value of a non-financial asset is only relevant to users of the financial statements if the SME is likely to sell the item in the near future. Most PPE is used within the business for its useful life and then scrapped.

A3. The following points cover the main reasons given by respondents to the RfI for permitting an entity to choose, for each major class of PPE, whether to apply the cost model or the revaluation model:

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

(b) The revaluation model is not complex and is already commonly applied by small entities in many jurisdictions. Not allowing a revaluation option may be a barrier to adoption of the *IFRS for SMEs* in some jurisdictions, eg where revaluation is compulsory or SMEs commonly revalue their PPE.

(c) Allowing the revaluation model for PPE may improve access to loan financing and enable entities to better comply with debt-equity ratios in loan covenants. If entities are currently applying a revaluation model under local GAAP, a change to a cost model on adoption of the *IFRS for SMEs* may affect borrowing arrangements.

(d) Measuring property at fair value presents a more accurate reflection of financial position. SMEs should not be prohibited from providing users of financial statements with the most up to date and relevant information.

(e) It is important that entities with significant PPE operating in high inflationary economies or in countries with restrictions relating to foreign currency exchange can revalue those items. In high inflationary economies historic cost will be much lower than current cost. Whilst income increases by inflation, depreciation does not unless the PPE is revalued.

(f) Although allowing a revaluation option would reduce comparability between SMEs, the option is currently permitted under full IFRSs. It could be argued comparability between listed companies is more important than SMEs. Many entities want to revalue PPE to be comparable with entities applying full IFRSs. Plus, banks and lenders want to be able to compare entities across industry segments.

(g) Allowing full IFRS accounting policy options in the *IFRS for SMEs* would enable subsidiaries that need to prepare information for consolidation purposes under full IFRSs to align their accounting policies with those of the group. Options also facilitate entities transitioning from the *IFRS for SMEs* to full IFRSs.

A4. Other suggestions made by respondents to the RfI include:

(a) Companies could provide revaluation disclosures in the notes to the financial statements.

(b) More complex options, eg the revaluation model, could be included in an appendix to the *IFRS for SMEs* or included within a separate box within the relevant sections. This would allow SMEs that do not want to use complex options to easily ignore the additional requirements. The IASB could also signal which is the simpler option by having a default option (eg cost model) and a permitted alternative (eg revaluation model) to ensure entities do not have to spend resources determining the less costly alternative.

(c) If options are inserted in separate boxed sections (or in an appendix), jurisdictions could easily choose to include or exclude them as appropriate when adopting the *IFRS for SMEs*. This would be better than each jurisdiction adapting the *IFRS for SMEs* themselves and writing their own options (eg as has been done in the UK). The IASB could also publish a core *IFRS for SMEs* (ie excluding all the boxed sections) for jurisdictions where complex options are considered not to be required.

Capitalisation of borrowing costs/development costs

A5. Paragraph A2 covers the main reasons provided by respondents to the RfI for not permitting complex options. In particular, that they generally increase complexity and costs for both preparers and users.

A6. The following points cover the main other reasons given by respondents to the RfI for not changing the current requirement to expense all borrowing costs/development costs:

(a) Requirements to capitalise borrowing/development costs under full IFRSs are too complex for SMEs. For example, the judgments and estimates necessary to distinguishing the research phase from the development phase and determine when the criteria for capitalisation of development costs are met are onerous for SMEs. Similarly the judgement and calculations required in determining which borrowing costs to capitalise, and over what period, are complex. Many SMEs do not have sufficient expertise or the systems in place to apply these requirements properly and this would result in poor quality financial information.

(b) Requiring smaller entities to capitalise certain development/borrowing costs would increase costs without adding significant benefits to users of their financial statements. For example capitalising borrowing costs does not provide lenders with information about whether the SME can pay back the related debt.

(c) It is not clear why the IASB is reconsidering its decision to simplify the approach in full IFRSs for SMEs which was made because of concerns over the cost-benefit implications of requiring capitalisation. The RfI does not provide any evidence suggesting these concerns are no longer valid.

(d) Requiring or allowing capitalisation of development/borrowing costs will increase complexity in other areas, for example deferred taxation. Expensing development costs is in line with the income tax treatment in many jurisdictions which adds to its simplicity.

(e) SMEs can disclose additional information, eg about the amount of borrowing/development costs expensed, in the notes to the financial statements if they believe it would be useful.

(f) If SMEs wish to apply complex accounting requirements, and have the expertise to do so properly, they can apply full IFRSs.

A7. The following points cover the main reasons given by respondents to the RfI for requiring capitalisation of borrowing and development costs meeting criteria for capitalisation in IAS 23/38:

(a) The recognition and measurement requirements of the *IFRS for SMEs* should be aligned with full IFRSs.

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

A8. The following points cover the main reasons given by respondents to the RfI for adding an accounting policy option for SMEs, rather than a requirement, to capitalise borrowing and development costs meeting criteria for capitalisation in IAS 23/38.

(a) This would have most of the benefits and few of the drawbacks listed in paragraphs A6-A7.

(b) The option would not add significant complexity to the *IFRS for SMEs* for SMEs because they can choose the simpler option, ie the cost model.

(c) Although allowing options to capitalise borrowing and development costs meeting criteria for capitalisation in IAS 23/38 would reduce comparability between SMEs, it would improve comparability of SMEs with companies applying full IFRSs.

(d) Including options in the *IFRS for SMEs* provides flexibility and makes it easier for jurisdictions to adopt the *IFRS for SMEs*. Many jurisdictions either require or permit a capitalisation approach for borrowing costs/development costs that is similar to full IFRSs. The current expense approach in the IFRS for SME is a deterrent to adoption in those jurisdictions.

(e) If SMEs have the expertise to capitalise borrowing/development costs in accordance with IAS 23/38, they should be allowed to. SMEs should not be prohibited from providing users of financial statements with the most up to date and relevant information.

A9. Other suggestions made by respondents to the RfI include:

(f) Require capitalisation of borrowing and development costs meeting criteria for capitalisation in IAS 23/38 if it would not result in undue cost or effort.

(g) Simplify the criteria in IAS 23/38 for SMEs. Examples given include simplify criteria for when development costs should be capitalised and only capitalise specific borrowing costs, ie not those from a general pool of borrowings.

(h) A number of other suggestions made by comment letters are similar to those summarised in paragraph A4, ie they cover ways of including accounting policy options within the Standard, eg use of separate boxed sections/appendix.