

STAFF PAPER

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IASB Meeting

Project	Disclosure Initiative: Materiality		
Paper topic	Entities applying the <i>IFRS for SMEs</i> Standard		
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Purpose of this paper

1. This paper considers the comments received on the Exposure Draft and should be read together with Agenda Paper 11 *Materiality - Cover paper*. It asks the Board whether the guidance in the final *Practice Statement* should be addressed also to entities applying *IFRS for SMEs*[®] Standard.

Considerations presented in the Exposure Draft

2. The Exposure Draft was addressed only to entities applying full IFRS Standards.
3. The Introduction of the Exposure Draft clarified that the aim of the document was to provide guidance to assist entities in ‘applying the concept of materiality to general purpose financial statements *prepared in accordance with International Financial Reporting Standards (IFRS)*’ [emphasis added] (paragraph IN1 of the Exposure Draft).
4. The same concept was outlined in paragraphs 1 and 2 of the Exposure Draft. Both paragraphs intended to refer to the application of materiality to financial statements prepared in accordance with full IFRS Standards.

Summary of the feedback

5. We received a small number of comments asking the Board to consider the applicability of the final *Practice Statement* to entities applying the *IFRS for SMEs* Standard.
6. The Group of Latin American Accounting Standard Setters (GLASS) recommended that:

... the guidelines expressly indicate that this also apply to entities that have no [public reporting] responsibility (non-listed entities, or SMEs) both in their consolidated and separate financial statements. This is particularly important for those Latin American countries in which general purpose separate financial statements are required or where the IFRS for SME is used (CL86).
7. Similarly, the Institute of Chartered Accountants of Guyana suggested the Board should ‘consider the implications of the [draft] Practice Statement on the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)’ (CL80).

Staff analysis and recommendation

8. We discussed the application of materiality in the context of *IFRS for SMEs* Standard with the staff involved in the development and the review of that Standard.
9. The *IFRS for SMEs* Standard is a separate and stand-alone accounting framework ‘based on full IFRS Standards with modifications to reflect the needs of users of SMEs’ financial and cost-benefit considerations’ (paragraph P9 of the *IFRS for SMEs* Standard). We also note that since the *IFRS for SMEs* Standard was developed in 2009, there have been a number of significant changes to full IFRS Standards that have not been incorporated in the *IFRS for SMEs* Standard¹.

¹ Refer to Agenda Paper 7 *Timing of the next review of the IFRS for SMEs Standard* presented to the Board in October 2016, for a comprehensive presentation of the changes to full IFRS Standards not yet incorporated in the *IFRS for SMEs* Standard.

10. The description of materiality in the *IFRS for SMEs* Standard is similar to that included in full IFRS Standards:

Information is material—and therefore has relevance—if its omission or misstatement could influence the economic decisions of users made on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. However, it is inappropriate to make, or leave uncorrected, immaterial departures from the IFRS for SMEs to achieve a particular presentation of an entity's financial position, financial performance or cash flows (paragraph 2.6 of *IFRS for SMEs* Standard).

11. However, the *IFRS for SMEs* Standard does not explicitly include the following concepts:
- (a) primary users of general purpose financial statements; and
 - (b) immaterial information should not obscure material information.

Primary users

12. The *IFRS for SMEs* Standard does not refer to the concept of *primary users* as included in the Conceptual Framework for Financial Reporting (the *Conceptual Framework*).
13. The *Conceptual Framework* considers as primary users of an entity's general purpose financial statements 'existing and potential investors, lenders and other creditors'².
14. On the other hand, the Basis for Conclusions of the *IFRS for SMEs* Standard notes that:

... The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a

² Paragraph OB5 of the *Conceptual Framework* states: 'Many existing and potential investors, lenders and other creditors cannot require entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, *they are the primary users to whom general purpose financial reports are directed.*' [emphasis added].

wide range of users in making economic decisions [emphasis added] (paragraph BC44 of the Basis for Conclusions on the *IFRS for SMEs* Standard).

15. According to the *IFRS for SMEs* Standard, small and medium sized entities (SMEs) are entities that ‘do not have public accountability’³ (paragraph 1.2 of *IFRS for SMEs* Standard). Therefore SMEs do not have, among their primary users, investors in capital markets and generally would be expected to have few outside investors that have no involvement in managing the business. Examples of external users of a SME’s financial statements include ‘owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies’ (paragraph 1.2 of *IFRS for SMEs* Standard).
16. Consequently, the primary users of entities applying the *IFRS for SMEs* Standard constitute a subset of the primary users defined in the *Conceptual Framework* because outside investors in capital markets are excluded.
17. Moreover, the information needs of an SME’s users might not be aligned with those of the primary users of full IFRS Standards financial statements:

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 (paragraph BC45 of

³ As defined in paragraph 1.3 of the *IFRS for SMEs* Standard.

the Basis for Conclusions on the *IFRS for SMEs* Standard).

18. We also note that users of the financial statements of an entity applying the *IFRS for SMEs* Standard would usually be close to the entity and so would likely be able to obtain the information they need directly from the entity without having to rely on general purpose financial statements.
19. At its October 2016 meeting, the Board tentatively decided to:
 - (a) refer to ‘primary users’ as defined by the *Conceptual Framework* throughout the final *Practice Statement*; and
 - (b) emphasise, in the final *Practice Statement*, that ‘primary users’ of an entity’s financial statements prepared in accordance with full IFRS Standards include potential investors, potential lenders and potential other creditors.
20. In conclusion we observe that the final *Practice Statement* focuses on primary users of financial statements prepared using full IFRS Standards. Their perspective may differ from the perspective of primary users of financial statements prepared using the *IFRS for SMEs* Standard.

Obscuring information

21. Paragraph 30A of IAS 1 *Presentation of Financial Statements* requires an entity to not reduce the understandability of its financial statements by obscuring material information with immaterial information.
22. Paragraph 30A was added to IAS 1 in December 2014 as part of the Disclosure Initiative. The *IFRS for SMEs* Standard has not been updated to incorporate this amendment, and thus does not include the concept of ‘obscuring material information’.

Staff recommendation

23. Some of the guidance provided in the final *Practice Statement* could be beneficial for entities applying the *IFRS for SMEs* Standard. In paragraph 10.6, the *IFRS for SMEs* Standard explicitly refers to the full IFRS Standards by saying that in

making judgemental decisions, entities applying the *IFRS for SMEs* Standard ‘may also consider the requirements and guidance in full IFRS dealing with similar and related issues’.

24. However, in the light of the difference between the *IFRS for SMEs* Standard and the full IFRS Standards and the differences in the group of users being considered and their needs, we suggest that the Board does not address the final *Practice Statement* to entities applying the *IFRS for SMEs* Standard.
25. To avoid any potential confusion, we recommend that, in the final *Practice Statement*, the Board should state that:
- (a) the final *Practice Statement* is not addressed to entities applying *IFRS for SMEs* Standard; and
 - (b) notwithstanding the differences between the two frameworks, some of the guidance in the final *Practice Statement* might be useful in preparing financial statements in accordance with *IFRS for SMEs* Standard.

Question for the Board

Question 1—*IFRS for SMEs* Standard

- (a) Do you agree that the Board should state in the final *Practice Statement* that it is not intended for entities applying the *IFRS for SMEs* Standard?
- (b) If yes, do you agree that the Board should state, in the final *Practice Statement*, that some of the guidance might be helpful for entities applying the *IFRS for SMEs* Standard?