

## STAFF PAPER

May 2019

IASB<sup>®</sup> Meeting

Project	Comprehensive review of the <i>IFRS for SMEs</i> <sup>®</sup> Standard		
Paper topic	Approach to the 2019 comprehensive review of the IFRS for SMEs Standard		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS<sup>®</sup> Standards or the *IFRS for SMEs*<sup>®</sup> Standard do not purport to set out acceptable or unacceptable application of IFRS Standards or the *IFRS for SMEs* Standard. Technical decisions are made in public and reported in IASB<sup>®</sup> *Update*.

## Purpose

1. The objective of this paper is to:
  - (a) provide the International Accounting Standards Board (Board) with:
    - (i) the background to the 2019 comprehensive review of the *IFRS for SMEs* Standard (2019 Review);
    - (ii) an update on the status of the 2019 Review; and
  - (b) agree the Board's approach to whether, and if so how, the *IFRS for SMEs* Standard should be aligned with full IFRS Standards.

## Structure of the paper

2. This paper is structured as follows:
  - (a) background to the 2019 Review (paragraphs 3–6);
  - (b) status of the 2019 Review (paragraphs 7–10);
  - (c) aligning the *IFRS for SMEs* Standard with full IFRS Standards (paragraphs 11–21);

- (d) whether and how the *IFRS for SMEs* Standard should be aligned with full IFRS Standards (paragraphs 22–49).

### **Background to the 2019 Review**

3. Paragraphs 7–21 provide a summary of the discussions at the February and March 2019 Board meetings.
4. In the preface to the *IFRS for SMEs* Standard, the Board states that it expects to reviewing the *IFRS for SMEs* Standard no more frequently than once every three years<sup>1</sup>.
5. The first comprehensive review of the *IFRS for SMEs* Standard commenced in 2012 (2012 Review) and culminated in the Board issuing the *2015 Amendments to the IFRS for SMEs* which became effective on 1 January 2017.
6. As part of the 2012 Review, the Board decided subsequent reviews of the *IFRS for SMEs* Standard should commence two years after the effective date of the amendments from the previous review<sup>2</sup>, in this instance, after 1 January 2019.

### **Status of the 2019 Review**

#### ***Focus of the Request for Information***

7. At the February 2019 meeting, the Board tentatively decided that in developing the Request for Information (RFI) it would discuss the following topics:
  - (a) IFRS Standards and amendments with effective dates up to and including 1 January 2019 that are not currently included in the *IFRS for SMEs* Standard;

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<sup>1</sup> Paragraph P16.

<sup>2</sup> Paragraph BC264(a). Note all references to BC Paragraphs refer to the Basis for Conclusions on *International Financial Standard for Small and Medium-sized Entities* issued in 2015.

- (b) other matters related to the *IFRS for SMEs* Standard, including:
  - (i) differences between IFRS Standards and the *IFRS for SMEs* Standard; and
  - (ii) matters of interest to entities applying the *IFRS for SMEs* Standard but not covered by IFRS Standards.
  
- 8. The Board also noted that a significant number of IFRS Standards and amendments would need to be considered for incorporation into the *IFRS for SMEs* Standard as part of the 2019 Review. Consequently, the Board tentatively decided the RFI should specifically request views on whether and, if so, how the *IFRS for SMEs* Standard should be updated to take account of full IFRS Standards and amendments not currently incorporated into the *IFRS for SMEs* Standard.
  
- 9. At the March 2019 meeting the Board discussed:
  - (a) whether the *IFRS for SMEs* Standard should be aligned with full IFRS Standards; and
  - (b) the principles to apply when considering whether and how the *IFRS for SMEs* Standard should be updated for new and amended IFRS Standards.
  
- 10. At the March 2019 Board meeting some Board members raised a question regarding the approach to deciding whether and, if so, how the *IFRS for SMEs* Standard should be updated to take account of full IFRS Standards and amendments. These Board members expressed reservations about the approach proposed by staff and said the Board should prioritise a stable platform, only updating the *IFRS for SMEs* Standard for specific problems brought to its attention.

### **Aligning the *IFRS for SMEs* Standard with full IFRS Standards**

- 11. At the March 2019 Board meeting, the staff proposed that to determine whether, and how, to align the *IFRS for SMEs* Standard with new and amended IFRS Standards, the Board could apply three principles (alignment principles):
  - (a) relevance;
  - (b) simplicity; and

- (c) faithful representation.<sup>3</sup>

*Principle 1—relevance*

12. The staff recommended that in determining whether, and how, to align the *IFRS for SMEs* Standard with new and amended IFRS Standards, the Board first evaluates whether the problem the IFRS Standard seeks to address is relevant to entities applying the *IFRS for SMEs* Standard. This principle assesses whether aligning with a new or amended IFRS Standard would make a difference in the decision of users of financial statements. The staff believes this principle addresses the qualitative characteristic of relevance.
13. If the Board concludes that principle 1 would be satisfied by aligning the *IFRS for SMEs* Standard with the full IFRS Standards, the Board would then apply principle 2.

*Principle 2—simplicity*

14. The *IFRS for SMEs* Standard provides simplified accounting requirements that are appropriate for entities applying the Standard. In so doing, the Standard reduces the cost of preparing financial statements and addresses the needs of users of these financial statements.
15. Simplicity is achieved by making simplifications to recognition and measurement requirements, reductions in the number of disclosures required under that IFRS Standard and simplifications to language. Paragraph BC16 of the *IFRS for SMEs* Standard sets out five ways in which the requirements of full IFRS Standards can be simplified in the *IFRS for SMEs* Standard. They include:
- (a) omitting some topics;
  - (b) where an IFRS Standard permits options, permitting only the simpler option;
  - (c) simplifying recognition and measurement requirements;

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<sup>3</sup> On the advice of the Board, the third principle—‘proportionality’—has been changed to ‘faithful representation’. However, the application of the principle remains the same.

(d) reducing disclosures; and

(e) simplifying language.

16. If the Board concludes that principle 2 would be satisfied by simplifying the requirements of the full Standard, the Board would then apply principle 3.

*Principle 3—faithful representation<sup>4</sup>*

17. While simplifications reduce the cost of applying the *IFRS for SMEs* Standard, those financial statements must still provide information that is useful for decision-making by a broad range of users. At times, these users are not in a position to demand reports tailored to meet their particular information needs. Principle 3 seeks to ensure that financial statements prepared applying the *IFRS for SMEs* Standard faithfully represent the substance of the phenomena they purport to represent<sup>5</sup>.

***Feedback at the March 2019 Board meeting***

18. At the March 2019 meeting Board members expressed different views on whether and how to align the *IFRS for SMEs* Standard with new and amended IFRS Standards.
- (a) Some Board members agreed with the staff recommendations that the Board should assess whether, and how, to align the *IFRS for SMEs* Standard with new and amended IFRS Standards by applying the alignment principles.
- (b) Other Board members expressed the view that the *IFRS for SMEs* Standard should provide a stable platform that is only updated for specific problems brought to the Board’s attention.
19. The Board instructed the staff to prepare a paper that demonstrates how the alignment principles would be applied when determining whether, and how, to align the *IFRS for SMEs* Standard with new and amended IFRS Standards. The Board

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<sup>4</sup> On the advice of the Board, the third principle—‘proportionality’—has been changed to ‘faithful representation’. However, the application of the principle remains the same.

<sup>5</sup> *Conceptual Framework*, paragraph 2.12, see also Section 2 *Concepts and Pervasive Principles* paragraph 2.7

proposed demonstrating application of the alignment principles to IFRS 16 *Leases* as it is a new IFRS Standard and addresses an existing section of the *IFRS for SMEs* Standard.

20. Agenda paper 30B of this meeting is an education paper that demonstrates how the alignment principles for alignment would be applied when determining whether, and how, to align Section 20 *Leases* of the *IFRS for SMEs* Standard with IFRS 16.
21. Board members are asked to provide feedback on the approach to whether, and how, to align the *IFRS for SMEs* Standard should be aligned with IFRS 16, including how the staff have applied the alignment principles. Board members are not asked to comment on the technical merits of the proposals in agenda paper 30A.

### **Whether and how the *IFRS for SMEs* Standard should be aligned with Full IFRS Standards**

#### ***Background to development of the IFRS for SMEs Standard***

22. As discussed at the March 2019 Board meeting, agenda paper 30, the Preface to the *IFRS for SMEs* Standard states that:

The *IFRS for SMEs* is based on full IFRS with modifications to reflect the needs of users of SMEs' financial statements and cost-benefit considerations.<sup>6</sup>

23. This is reinforced in paragraph BC95(a) which states that the *IFRS for SMEs* Standard was developed by:

... extracting the fundamental concepts from the *Framework* and the principles and related mandatory guidance from IFRSs (including Interpretations).

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<sup>6</sup> Paragraph P9.

24. Paragraph BC96 states that:

... this approach is 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. Therefore, full IFRSs are the logical starting point for developing an *IFRS for SMEs*.

25. The staff noted, in agenda paper 30 at the March 2019 Board meeting, that using full IFRS Standards as the basis for the *IFRS for SMEs* Standard brings benefits in addition to those identified in paragraph BC96, including:

- (a) efficiencies for preparers, auditors, regulators and users of financial statements prepared in accordance with either full IFRS Standards or the *IFRS for SMEs* Standard; and
- (b) a consistent financial reporting framework which supports efficiency in the education of accountants and users.

26. When developing the original *IFRS for SMEs* Standard the Board stated<sup>7</sup>:

- (a) The purpose of the *IFRS for SMEs* Standard was to:
  - (i) provide a single set of high quality, understandable, and enforceable accounting standards suitable for SMEs throughout the world;
  - (ii) focus on meeting the needs of users of SME financial statements;
  - (iii) reduce the financial reporting burden on SMEs that want to use IFRS Standards;
  - (iv) be built on the same conceptual framework as IFRS Standards; and
  - (v) allow easy transition to full IFRS Standards for those SMEs that grow or choose to switch to full IFRS Standards.

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<sup>7</sup> IASB Update February 2004

27. In doing so, the *IFRS for SMEs* Standard was expected to bring the following benefits:
- (a) improving the comparability of SMEs’ financial information at the national or international level;
  - (b) making it easier to implement planned cross-border acquisitions and to initiate proposed partnerships or cooperation agreements with foreign entities;
  - (c) helping SMEs trade internationally; and
  - (d) enhancing the financial health of SMEs.

***Small and Medium-sized Entities Implementation Group (SMEIG) views***

28. In March 2019 the staff asked members of the SMEIG for their views on the advantages and disadvantages of alignment between full IFRS Standards and the *IFRS for SMEs* Standard.
29. We received responses from over a third of the SMEIG members. Of these members, most noted alignment between full IFRS Standards and the *IFRS for SMEs* Standard was important.
30. SMEIG members who supported alignment did so for similar reasons to those identified earlier in this paper. Those members that did not support alignment were concerned about the risk of complicating the *IFRS for SMEs* Standard.

***Staff analysis***

31. As noted above at the March 2019 Board meeting, Board members expressed differing views regarding whether, and how to, incorporate new and amended IFRS Standards into the *IFRS for SMEs* Standard. We have categorised these views as:
- (a) View 1—the *IFRS for SMEs* Standard should be aligned with new and amended IFRS Standards, in determining alignment the Board should apply the alignment principles.

- (b) View 2—the *IFRS for SMEs* Standard should provide a stable platform that is only updated for specific problems brought to the Board’s attention.

*Staff analysis of View 1— the IFRS for SMEs Standard should be aligned with new and amended IFRS Standards, in determining alignment the Board should apply the alignment principles.*

32. The benefits of alignment of the *IFRS for SMEs* Standard with full IFRS Standards that were identified by the Board when the *IFRS for SMEs* Standard was originally developed are discussed above in paragraph 25. It is important to note that when aligning the *IFRS for SMEs* Standard with full IFRS Standards the focus is on extracting the fundamental concepts of IFRS Standards and simplifying those concepts.
33. This process is expected to produce a Standard that is significantly shorter and less complex than full IFRS Standards. In doing so it should meet the purpose of the *IFRS for SMEs* Standard, as outlined at paragraph 26.
34. The Board members that supported this approach at the March 2019 meeting noted the additional efficiency and effectiveness of relying on work already completed by the Board to develop or amend IFRS Standards.
35. Board members in favour of alignment also noted that the title of the *IFRS for SMEs* Standard implies a direct relationship with full IFRS Standards and expressed the view that preparers, users and educators placed some reliance on that implied relationship.
36. Some Board members also noted that the importance of alignment was raised by constituents during the 2012 Review, most notably in the discussion around the alignment of Section 29 *Income Tax* of the *IFRS for SMEs* Standard with IAS 12 *Income Tax*.

37. Staff have also heard arguments that alignment creates a pathway for developing economies, who can utilise the *IFRS for SMEs* Standard as an intermediate step to adoption of full IFRS Standards.<sup>8</sup>
38. The alignment principles the staff proposed at the March 2019 Board meeting (agenda paper 30) are intended to provide a framework for the Board to make decisions as part of the 2019 Review on whether, and if so how, the *IFRS for SMEs* Standard should be aligned with each full IFRS Standard it is not currently aligned with.
39. The staff notes that as discussed by the Board at the March 2019 meeting, aligning the *IFRS for SMEs* Standard with full IFRS Standards does not prevent the Board including:
- (a) requirements that are different from those in full IFRS Standards. For example, amortisation of goodwill is required for entities applying the *IFRS for SMEs* Standard; or
  - (b) developing requirements for matters not addressed specifically in full IFRS Standards. For example, cryptocurrency.
40. As discussed above, in addition to proposals regarding amendments and new IFRS Standards, the staff plans to present issues raised by *IFRS for SMEs* Standard stakeholders (for example, requirements to treat development costs as expenses) and matters that are of interest to SMEs but not covered by IFRS Standards (for example, cryptocurrency).

*Staff analysis of view 2– the IFRS for SMEs Standard should provide a stable platform that is only updated for specific problems brought to the Board's attention.*

41. At the March 2019 Board meeting, some Board members expressed support for an approach that would respond directly to the requirements of entities applying the *IFRS for SMEs* Standard. Consequently, the approach would be driven by specific

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<sup>8</sup> Most recently this was expressed by members of the IFRS Foundation's Advisory Council at the March 2019 meeting.

issues already brought to the attention of the Board or that come to the Board's attention during the course of the 2019 Review.

42. The Board members that support this approach noted the following reasons:
- (a) it maintains a stable platform, that is it minimises disruption and the cost of a significant update for entities applying the *IFRS for SMEs* Standard;
  - (b) reflects that the Board has not heard significant concerns about the current *IFRS for SMEs* Standard, and that it appears to generally be working well;
  - (c) involves limited re-education of stakeholders;
  - (d) minimises costs for jurisdictions who need to translate the Standard and related educational materials; and
  - (e) reduces the risk of unintended consequences of making significant changes.
43. Board members that supported view 2, cautioned that starting with full IFRS Standards risked imposing requirements that were either not relevant or too complex for entities applying the *IFRS for SMEs* Standard and the information needs of their users. These Board members acknowledged this approach could require additional work from the Board but believed it would result in a more relevant and effective Standard.
44. It should be noted that when developing the *IFRS for SMEs* Standard, the Board considered an alternative approach, the 'fresh start' approach, which would have involved developing a standard independent of full IFRS Standards, along with a separate conceptual framework. This was rejected because the Board believed the approach could result in:
- (a) financial reports with different objectives;
  - (b) financial information with different qualitative characteristics; and
  - (c) differing concepts of recognition and measurement.

45. The Board also observed significant congruence between users’ needs and the general purpose financial statements of entities with or without public accountability, and concluded that a fresh start approach would be:
- (a) costly;
  - (b) time-consuming; and
  - (c) ultimately futile.
46. An approach based on view 2 could lead to the *IFRS for SMEs* Standard diverging from full IFRS Standards to such an extent that in the long-term they would be considered unrelated Standards.

**Recommendation**

47. The staff has considered the points raised by Board members at the March 2019 Board meeting.
48. The staff believe that the approach described as view 2, that the *IFRS for SMEs* Standard should provide a stable platform that is only updated for specific problems brought to the Board’s attention, would represent a significant departure from the original intention of the Board when developing the *IFRS for SMEs* Standard. The staff also considers that such an approach would require an extensive reconsideration of the purpose of *IFRS for SMEs* and of its principles and concepts. The staff are not aware of any research or feedback indicating the need for this.
49. The staff therefore continue to support view 1; that the *IFRS for SMEs* Standard should be aligned with new and amended IFRS Standards using the alignment principles of relevance, simplicity and faithful representation.

**Question 1**

Does the Board agree with the staff recommendation in paragraph 49?