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STAFF PAPER

IASB® Meeting

Project	**Comprehensive review of the *IFRS for SMEs*® Standard**		
Paper topic	Scope of the *IFRS for SMEs* Standard		
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Purpose

1. At this meeting we are asking Board members if the Request for Information, that will be issued as part of the 2019 Comprehensive Review of the *IFRS for SMEs* Standard (2019 Review), should seek views not to amend the scope of the *IFRS for SMEs* Standard.

2. The objective of the Request for Information is to obtain evidence that will assist the Board in deciding whether and how to develop an exposure draft of amendments to the *IFRS for SMEs* Standard.

Summary of staff recommendation

3. The staff recommends that the Board seek views in the Request for Information not to amend the scope of the *IFRS for SMEs* Standard.

Structure of the paper

4. This paper is structured as follows:

   (a) Background (paragraphs 5–7);

   (b) Scope of the *IFRS for SMEs* Standard (paragraphs 8–12);

(c) The 2012 Comprehensive Review of the *IFRS for SMEs* Standard (paragraphs 13–17);

(d) The 2019 Comprehensive Review of the *IFRS for SMEs* Standard (paragraphs 18–30);

(e) Staff analysis (paragraphs 31–39);

(f) Staff recommendation and question for the Board (paragraphs 40–44);

(g) Appendix A— Extract on public accountability from the 2012 Comprehensive Review of the *IFRS for SMEs* Standard.

Background

5. In developing the *IFRS for SMEs* Standard one of the first issues confronting the Board was to describe the class of entities for which the Standard was intend. The Basis for Conclusions notes[1]:

> … a clear definition of the class of entity for which the *IFRS for SMEs* [Standard] is intended is essential so that:
>
> (a) the Board can decide on the standard that is appropriate for that class of entity; and
>
> (b) national regulatory authorities, standard-setters, reporting entities and their auditors will be informed of the intended scope of applicability of the *IFRS for SMEs* [Standard].

6. The *IFRS for SMEs* Standard is intended for use by small and medium sized entities (SMEs). The Standard describes SMEs as those entities that do not have *public accountability* and *publish general purpose financial statements* for external users[2].

7. In developing the *IFRS for SMEs* Standard, the Board also recognised that the decision to adopt the Standard ultimately rests with jurisdictions, specifically, with national standard-setters and regulatory authorities. The Board cannot prohibit

[1] *IFRS for SMEs* Standard paragraph BC55.

[2] *IFRS for SMEs* Standard paragraph 1.2.

jurisdictions from permitting or requiring publicly accountable entities to apply the Standard. However, paragraph 1.5 of the *IFRS for SMEs* Standard states that:

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

Scope of the *IFRS for SMEs* Standard

Definition of public accountability

8. Paragraph 1.3 of the *IFRS for SMEs* Standard states:

> An entity has public accountability if:
>
> (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
>
> (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).

9. Public accountability is the principle used in identifying the entities for which the *IFRS for SMEs* Standard is intended and those for which it is not.

10. In developing the scope of the *IFRS for SMEs* Standard, the Board considered whether the following types of entities should be permitted to apply the Standard:

    (a) entities whose securities are traded in public markets;

    (b) financial institutions that hold assets in a fiduciary capacity;

    (c) SMEs providing essential public services; and

(d) SMEs that are economically significant in their home jurisdictions.

11. The Board concluded, when developing the *IFRS for SMEs* Standard (2009), that the following types of entity have public accountability:

(a) **Entities whose securities are traded in a public market**—an entity's decision to enter a public capital market makes it publicly accountable. It must provide outside debt and equity investors with a broader range of financial information than may be needed by users of financial statements of entities that obtain capital only from private sources. The Board concluded that, regardless of size, entities whose securities are traded in a public capital market should follow full IFRS Standards.[3]

(b) **Financial institutions that hold assets in a fiduciary capacity**—the primary business of banks, insurance companies, securities brokers/dealers, pension funds, mutual funds and investment banks is to hold and manage financial resources entrusted to them by a broad group of clients, customers or members who are not involved in the management of these entities. Because such an entity acts in a public fiduciary capacity, it is publicly accountable.[4]

12. The Board also concluded that the following types of entity do not have public accountability, and may therefore apply the *IFRS for SMEs* Standard:

(a) **SMEs providing essential public services**—although the Board had originally proposed a public utility or a similar entity that provides an essential public service was publicly accountable; it received feedback that entities that provide public services can be very small, for example, refuse collection companies, water companies, local power-generating or distributing companies and local cable television companies. The Board concluded that the nature of the users of the financial statements, rather

[3] *IFRS for SMEs* Standard paragraph BC58.

[4] *IFRS for SMEs* Standard paragraph BC59.

than the nature of the business activity, should determine whether full IFRS Standards should be required.[5]

(b) **SMEs that are economically significant in their home jurisdictions**—following feedback the Board concluded that economically significant entities may be more relevant to matters of political and societal accountability rather than public accountability. Whether such accountability requires general purpose financial statements prepared using full IFRS Standards is a matter best left to local jurisdictions to decide.[6]

The 2012 Comprehensive Review of the *IFRS for SMEs* Standard

13. The 2012 Request for Information, issued as part of the 2012 Comprehensive Review of the *IFRS for SMEs* Standard (2012 Review), asked whether the scope requirements of the *IFRS for SMEs* Standard are too restrictive. The questions from the 2012 Request for Information are set out in Appendix A.

14. The Board received mixed feedback on the scope requirements of the *IFRS for SMEs* Standard in response to the 2012 Request for Information. The Board received further feedback on the scope requirements of the Standard in response to the Exposure Draft of proposed amendments to the *IFRS for SMEs* Standard, published in 2013, which followed the Request for Information.

15. Some respondents to the 2012 Request for Information and the 2013 Exposure Draft supported revising the scope of the *IFRS for SMEs* Standard. Some of these respondents did not think that the scope should be restricted to entities whose debt or equity instruments are traded in a public market. These respondents stated:

(a) Due to the extensive requirements of full IFRS Standards, some jurisdictions do not require publicly traded entities to apply full IFRS Standards. That said, some jurisdictions lack local expertise to develop

[5] *IFRS for SMEs* Standard paragraph BC60 and paragraph BC61.

[6] *IFRS for SMEs* Standard paragraph BC63.

their own accounting standards. Consequently, publicly traded entities use local accounting standards that are inferior to the *IFRS for SMEs* Standard. Permitting such entities to apply the *IFRS for SMEs* Standard could improve financial reporting in those jurisdictions and place these jurisdictions on a path to adopting full IFRS Standards as (i) capital markets develop; (ii) the knowledge of IFRS Standards develops; and (iii) the infrastructure for financial reporting develops. In addition, permitting application of the *IFRS for SMEs* Standard would lead to greater comparability worldwide through use of an internationally acceptable Standard that is closely linked to full IFRS Standards.

(b) Restricting the scope of the *IFRS for SMEs* Standard may pose unnecessary obstacles to adoption of the Standard in some jurisdictions because of conflicts with local laws and regulations.

(c) Some jurisdictions have junior equity markets that list small entities in which public interest is limited. Applying full IFRS Standards is not useful for these entities and they may find the Standard more suitable.

(d) The definition of public accountability includes small privately held entities with debt traded in an over-the-counter (OTC) market with limited market participants. Respondents said the *IFRS for SMEs* Standard would be more suitable for those entities.

16. Similarly, respondents to the 2012 Request for Information supported revising the scope of the *IFRS for SMEs* Standard to permit each jurisdiction to decide whether entities that holds assets in a fiduciary capacity as one of their primary businesses should be permitted or required to apply the Standard. Those respondents stated:

(a) The cost of compliance with full IFRS Standards is onerous to some smaller financial institutions, for example, very small credit unions and micro banks. These entities often lack the resources to implement full IFRS Standards effectively. Applying the *IFRS for SMEs* Standard might be less costly for these entities while maintaining useful information to users of their financial statements.

(b) Unlisted financial institutions do not have responsibilities related to public capital markets. Compliance with local laws and regulations is consequently deemed to be sufficient.

(c) Financial institutions and similar entities differ in nature and complexity around the world. Some small financial institutions have simple transactions and are similar in nature to small entities without public accountability. Local regulators may take the view that the Standard provides sufficient information for accountability purposes.

(d) The information needs of users of publicly traded entities are not necessarily the same as users of entities holding assets for a broad group of external stakeholders. For example, the most important factor in policyholders' decisions to buy, keep or transfer out of policies from a mutual insurer, is specific policy performance rather than general entity performance. Similar considerations may apply to credit unions.

(e) The definition of 'fiduciary' differs between jurisdictions and consequently lacks clarity.

17. Having considered responses received, the Board concluded that the scope of the Standard would not be amended and made the following observations:

> … if the scope was widened to include some publicly accountable entities, it may lead to pressure to make changes to the *IFRS for SMEs* to address issues that may arise from that wider group, which would increase the complexity of the *IFRS for SMEs*.
>
> After considering the responses to the 2013 [Exposure Draft], the IASB decided that there was no new information that would lead the IASB to reconsider its previous decision. Consequently, it decided to keep paragraph 1.5 of the *IFRS for SMEs*.[7]

[7] *IFRS for SMEs* Standard paragraph BC181.

The 2019 Comprehensive Review of the *IFRS for SMEs* Standard

Reasons for reconsidering the scope of the IFRS for SMEs *Standard*

18. At its meeting in February 2019 the Board tentatively decided to include the scope of the *IFRS for SMEs* Standard as part of the 2019 Review[8]. The staff recommended considering the scope of the *IFRS for SMEs* Standard in the 2019 Review, based on feedback from stakeholders. For example, the European Commission report *Building a Capital Markets Union*[9] noted that:

> The development of a simplified, common, and high-quality accounting standard tailored to the companies listed on certain trading venues could be a step forward in terms of transparency and comparability, and if applied proportionally, could help those companies seeking cross-border investors to be more attractive to them. The standard could become a feature of SME Growth Markets, and be available for wider use.

19. However, the report did not specifically mention the *IFRS for SMEs* Standard to be such a Standard.

Research on the scope of the IFRS for SMEs *Standard*

20. Following the feedback to the 2012 Review that some publicly accountable entities should be permitted to apply the *IFRS for SMEs* Standard, the staff sought advice on retaining the definition of public accountability but permitting exceptions to the definition to allow (for example) the following publicly accountable entities to apply the *IFRS for SMEs* Standard:

    (a) entities whose securities are traded in public markets only if:

        (i) these entities are small or narrowly held; or

        (ii) their securities are traded in alternative markets; or

[8] See ***February 2019 Agenda Paper 30***.

[9] European Commission, *Green Paper—Building a Capital Markets Union*, 2015, page 14.

(iii) their shares are not regularly traded; or

(iv) their shareholders unanimously agree;

(b) entities holding assets in a fiduciary capacity, in particular, small financial institutions, for example, small credit unions, small private banks and small building societies, only if:

(i) they have a strictly defined and limited group of members; or

(ii) they have fewer than a specified number of members; or

(iii) their members unanimously agree.

21. The staff has consulted the SME Implementation Group (SMEIG),[10] IFRS Advisory Council (Advisory Council), Emerging Economies Group (EEG) and the International Forum of Accounting Standard Setters (IFASS) on the scope of the *IFRS for SMEs* Standard.

Stakeholder feedback on research on the scope of the* IFRS for SMEs *Standard

Feedback from the SME Implementation Group

22. In March 2019, the staff asked members of the SMEIG their views on whether to amend the scope of the *IFRS for SMEs* Standard to allow some publicly accountable entities to apply the Standard by permitting exceptions to the definition of public accountability. Eight of the 26 SMEIG members responded:

(a) Six SMEIG members supported permitting exceptions to the definition of public accountability.

(b) Two SMEIG members did not support permitting exceptions to the definition of public accountability because these exceptions were probably too narrow and would be ineffective. They said that, for example, it would be impossible to satisfy the proposed exception requiring members of entities that hold assets in a fiduciary capacity to unanimously agree to

[10] A summary of the responses received from the SMEIG can be found in Appendix A.

apply the *IFRS for SMEs* Standard. This could be because not all members of entities attend meetings or have a clear understanding of the advantages of using either full IFRS Standards or the *IFRS for SMEs* Standard.

(c) Furthermore, those SMEIG members who did not support permitting exceptions to the definition of public accountability were of the view that entities with any form of public accountability should have sufficient resources to apply full IFRS Standards. These SMEIG members further reiterated that publicly accountable entities, although small in some cases, require more governance and accountability from outside the organisation. Financial statements prepared by entities applying the *IFRS for SMEs* Standard would be significantly less useful, and therefore, inappropriate for application by such entities.

Feedback from the IFRS Advisory Council

23. At its March 2019 meeting, the staff asked Advisory Council members their views on whether to amend the scope of the *IFRS for SMEs* Standard to allow some publicly accountable entities to apply the Standard by permitting exceptions to the definition of public accountability.[11]

24. Advisory Council members supported allowing individual jurisdictions to decide which entities should apply the *IFRS for SMEs* Standard. Advisory Council members made the following comments:

(a) If the Board were to consult on the scope of the *IFRS for SMEs* Standard, it may receive very diverse views on which entities with public accountability (if any) should be permitted to apply the Standard.

(b) The Standard was developed for entities that do not have public accountability. If exceptions are introduced to the definition of public accountability, it will fundamentally impact the Standard and might require a complete overhaul of the Standard. Such an overhaul would be

[11] See ***March 2019 Agenda Paper 7*** of the IFRS Advisory Council meeting.

inconsistent with the Board's statement that simplicity and stability are essential to the Standard.

(c) In considering the scope of the Standard, the Board may need to give further consideration to whether the *IFRS for SMEs* Standard should be viewed as 'roadmap' to full IFRS Standards.

25. Furthermore, some Advisory Council members highlighted concerns about providing exceptions to the definition of public accountability:

(a) the exceptions to the definition would introduce subjective elements and this would lead to diversity in practice;

(b) problems might arise if small financial institutions, like credit unions, apply the Standard and are not required to apply the expected credit model to measure impairment losses on financial assets; and

(c) the need to align the *IFRS for SMEs* Standard with full IFRS Standards would become greater and more urgent.

Feedback from the Emerging Economies Group[12]

26. At its March 2019 meeting, the staff asked the EEG members views on whether to amend the scope of the *IFRS for SMEs* Standard to allow some publicly accountable entities to apply the Standard by permitting exceptions to the definition of public accountability.[13]

27. Two EEG members thought the scope of the *IFRS for SMEs* Standard should not be extended because:

(a) other users might disagree with members' unanimous decision to apply the Standard (see paragraph 20(b)(iii)), resulting in a possible hurdle for an entity to apply the Standard; and

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[12] The Emerging Economies Group (EEG) was created in 2011 at the direction of the IFRS Foundation Trustees to enhance the participation of emerging economies in the development of IFRS Standards.

[13] EEG, *Report of the Emerging Economies Group meeting*, March 2019.

(b) the Standard might become increasingly complex if exceptions to the definition of public accountability are introduced.

28. One EEG member said that a positive potential result of extending the scope of the *IFRS for SMEs* Standard is that it would allow more entities to access the capital market, subject to satisfying listing requirements.

Feedback from International Forum of Accounting Standard Setters

29. At its March 2019 meeting, the staff asked the IFASS members their views on whether to amend the scope of the *IFRS for SMEs* Standard to allow some publicly accountable entities to apply the Standard by permitting exceptions to the definition of public accountability.

30. Overall IFASS members did not support the proposal to provide exemptions to the definition of public accountability. IFASS members comments included:

(a) drafting the exemptions would be very difficult;

(b) jurisdictions should be permitted to decide which entities should apply the *IFRS for SMEs* Standard; and

(c) comparability is not as significant in the SME sector as for entities applying full IFRS Standards;

Staff analysis

31. In developing and reviewing the *IFRS for SMEs* Standard the Board noted that a clear definition of the class of entity for which the *IFRS for SMEs* Standard is intended is essential so that the Board can decide on the Standard that is appropriate for that class of entity.

32. As explained above, as part of the 2012 Review the Board consulted on whether the scope of the *IFRS for SMEs* Standard was too restrictive. After consultation the Board decided not to amend the scope of the Standard because extending the scope may require changes to the Standard that would introduce complexity into the Standard.

33. As part 2019 Review, the staff has sought advice on permitting some publicly accountable entities to apply the Standard by permitting exceptions to the definition of public accountability. The advice received again raises concerns regarding introducing complexity and further defining the scope of the exceptions.

Complexity

34. The staff notes, based on the feedback from the Board's consultative groups set out in paragraphs 22–30, overall there is little support for permitting exceptions to the definition of public accountability.

35. The most significant reason provided was that permitting some publicly accountable entities to apply the *IFRS for SMEs* Standard could result in increased complexity and increased costs of maintaining the *IFRS for SMEs* Standard because the Standard would need to be updated to cater for publicly accountable entities.

36. The staff has considered the concern about complexity and notes that if the Board were to allow exceptions to the definition of public accountability by permitting some publicly accountable entities to apply the *IFRS for SMEs* Standard, changes to the Standard would need to be considered. For example:

    (a) the following topics not addressed in the Standard would need to be introduced in the Standard:[14]

        (i) topics applicable only to listed companies applying full IFRS Standards: earnings per share, interim financial reporting, segment reporting; and

        (ii) other topics: special accounting for assets held for sale and insurance contracts.

    (b) the Standard does not require entities to make the disclosures required by IFRS 7 *Financial Instruments: Disclosures* because they are designed for financial institutions (which are ineligible to use the Standard) or for entities whose securities are traded in public capital markets.[15] The Board

[14] *IFRS for SMEs* Standard paragraph BC87.

[15] *IFRS for SMEs* Standard paragraph BC107.

would have to consider requiring IFRS 7 disclosures if exceptions to the definition of public accountability were permitted.

Defining the scope of the exceptions

37. Another significant concern raised was defining the scope of the entities that have public accountability and would be permitted to apply the *IFRS for SMEs* Standard. The concern focused clearly defining the exceptions to the definition and the possible introduction of subjective elements.

38. The staff also notes that if such entities were permitted to apply the *IFRS for SMEs* Standard it would reduce information to users, including regulators, of financial statements, since financial statements would be prepared using the *IFRS for SMEs* Standard which has simpler requirements than the full IFRS Standards.

39. Furthermore, reduced comparability may occur among industry peers due to some entities continuing to apply the full IFRS Standards instead of the *IFRS for SMEs* Standard.

Staff recommendation and question for the Board

40. In view of the staff analysis the staff recommend that the Board sets out in the Request for Information the feedback received on staff's outreach and explains that, based on the feedback, the Board does not intend to amend the scope of the *IFRS for SMEs* Standard.

41. Paragraph 1.5 of the *IFRS for SMEs* Standard states that if a publicly accountable entity applies this Standard, its financial statements shall not be described as conforming to the Standard—even if law or regulation in its jurisdiction permits or requires this Standard to be used by publicly accountable entities. The staff recommend retaining this restriction.

42. The second alternative would be for the Board to seek views in the Request for Information on permitting exceptions to the definition of public accountability setting out the staff outreach findings.

43. The Request for Information would also explain the exceptions to the definition of public accountability and the *IFRS for SMEs* Standard would have to be amended as outlined in paragraph 36.

44. The staff does not recommend this alternative given the lack of support from stakeholders for permitting exceptions to the definition of public accountability (see paragraphs 22(b), 22(c), 24, 25, 27 and 30).

Question for the Board

Question for the Board
Does the Board agree with the staff recommendation that the Board seek views in the Request for Information not to amend the scope of the *IFRS for SMEs* Standard?

Appendix A— Extract on public accountability from the 2012 Comprehensive Review of the *IFRS for SME* Standard

A1. These questions are taken from the Request for Information published as part of the 2012 Comprehensive Review of the *IFRS for SMEs* Standard.

Question S1

Use by publicly traded entities (Section 1)

The *IFRS for SMEs* currently prohibits an entity whose debt or equity instruments are traded in a public market from using the *IFRS for SMEs* (paragraph 1.3(a)). The IASB concluded that all entities that choose to enter a public securities market become publicly accountable and, therefore, should use full IFRSs.

Some interested parties believe that governments and regulatory authorities in each individual jurisdiction should decide whether some publicly traded entities should be eligible to use the *IFRS for SMEs* on the basis of their assessment of the public interest, the needs of investors in their jurisdiction and the capabilities of those publicly traded companies to implement full IFRSs.

Are the scope requirements of the *IFRS for SMEs* currently too restrictive for publicly traded entities?

(a) No—do not change the current requirements. Continue to prohibit an entity whose debt or equity instruments trade in a public market from using the *IFRS for SMEs*.

(b) Yes—revise the scope of the *IFRS for SMEs* to permit each jurisdiction to decide whether entities whose debt or equity instruments are traded in a public market should be permitted or required to use the *IFRS for SMEs*.

(c) Other—please explain.

Please provide reasoning to support your choice (a), (b) or (c).

Question S2

Use by financial institutions (Section 1)

The *IFRS for SMEs* currently prohibits financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses from using the *IFRS for SMEs* (paragraph 1.3(b)). The IASB concluded that standing ready to take and hold funds from a broad group of outsiders makes those entities publicly accountable and, therefore, they should use full IFRSs. In every jurisdiction financial institutions are subject to regulation.

In some jurisdictions, financial institutions such as credit unions and micro banks are very small. Some believe that governments and regulatory authorities in each individual jurisdiction should decide whether some financial institutions should be eligible to use the *IFRS for SMEs* on the basis of their assessment of the public interest, the needs of investors in their jurisdiction and the capabilities of those financial institutions to implement full IFRSs.

Are the scope requirements of the *IFRS for SMEs* currently too restrictive for financial institutions and similar entities?

(a) No—do not change the current requirements. Continue to prohibit all financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses from using the *IFRS for SMEs*.

(b) Yes—revise the scope of the *IFRS for SMEs* to permit each jurisdiction to decide whether any financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses should be permitted or required to use the *IFRS for SMEs*.

(c) Other—please explain.

Please provide reasoning to support your choice of (a), (b) or (c).