

STAFF PAPER

February 2022

IASB[®] meeting

Project	Second Comprehensive Review of the <i>IFRS for SMEs</i> [®] Standard	
Paper topic	Towards an Exposure Draft—Other topics (Recognition and measurement of development costs)	
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Introduction

1. At its November 2021 meeting, the International Accounting Standards Board (IASB):
 - (a) discussed feedback to questions N4 and N5 in the Request for Information *Comprehensive review of the IFRS for SMEs Standard* published in January 2020; and
 - (b) decided to explore possible changes to the recognition and measurement of development costs in the *IFRS for SMEs* Standard.
2. In this paper, the term SMEs refers to small and medium-sized entities that are eligible to apply the *IFRS for SMEs* Standard.

Purpose of the paper

3. The purpose of this paper is to ask the IASB to:
 - (a) consider possible amendments to the recognition and measurement of development costs applying the principles of relevance to SMEs, simplicity and faithful representation; and

- (b) decide whether to seek views on the possible amendments to the recognition and measurement of development costs in the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard.

Summary of staff recommendation

- 4. The staff recommend the IASB seek views, in the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard, on requiring an SME to recognise intangible assets arising from development costs meeting the criteria in paragraphs 57(a)–(f) of IAS 38 *Intangible Assets* with an undue cost or effort exemption.

Structure of the paper

- 5. This paper is structured as follows:
 - (a) questions in the Request for Information (paragraphs 6–8 of this paper);
 - (b) background (paragraphs 9–12 of this paper);
 - (c) staff analysis:
 - (i) approaches to amending recognition and measurement requirements for development costs for SMEs—including SMEIG recommendations on the identified approaches (paragraphs 14–26 of this paper); and
 - (ii) applying the alignment principles to the recognition and measurement of developments costs for SMEs (paragraphs 27–43 of this paper); and
 - (d) staff recommendation and question for the IASB (paragraph 44 of this paper).

Questions in the Request for Information

- 6. Question N4 in the Request for Information asked whether there are any topics the *IFRS for SMEs* Standard does not address that respondents think should be the subject of specific requirements (for example, topics not addressed by the Standard for which

the general guidance in paragraphs 10.4–10.6 of the *IFRS for SMEs* Standard is insufficient).

7. Question N5 in the Request for Information asked respondents to describe any additional issues that they would like to bring to the IASB’s attention relating to the *IFRS for SMEs* Standard.
8. Feedback on the recognition and measurement of development costs was raised in responses to both questions N4 and N5 in the Request for Information.

Background

9. The *IFRS for SMEs* Standard requires an SME to expense development costs when incurred, whereas IAS 38 requires an entity:
 - (a) to recognise development costs that meet specified criteria as intangible assets. Paragraphs 57(a)–(f) of IAS 38 set out the criteria to recognise an intangible asset arising from development costs.
 - (b) to expense development costs that do not meet those criteria.
10. The *IFRS for SMEs* Standard simplifies the requirements of IFRS Accounting Standards. In developing the *IFRS for SMEs* Standard the IASB considered:
 - (a) the feedback from preparers and auditors that SMEs do not have the resources to assess whether a project is commercially viable on an ongoing basis; and
 - (b) the feedback from bank lending officers that information about development costs recognised as intangible assets is of little benefit in making lending decisions.¹
11. As part of the first comprehensive review of the *IFRS for SMEs* Standard, the IASB considered revisiting the requirement that SMEs recognise all development costs as an expense when incurred, including considering whether to give SMEs an accounting

¹ See paragraphs BC113–BC114 of the Basis for Conclusions on the *IFRS for SMEs* Standard.

policy option to recognise development costs based on similar criteria to IAS 38.² Although there was some support for introducing such an option, the IASB continued to look at the balance of costs and benefits, and chose to retain unchanged the recognition and measurement of development costs in the *IFRS for SMEs* Standard as part of the first comprehensive review.³

12. As part of the second comprehensive review of the *IFRS for SMEs* Standard, the IASB discussed the topic of recognition and measurement of development costs. At its November 2021 meeting:
- (a) the IASB considered the feedback on the Request for Information and the recommendations from the SME Implementation Group (SMEIG)⁴; and
 - (b) IASB members said that staff should explore possible amendments to the recognition and measurement of development costs so that the IASB could seek views on these possible amendments in the Exposure Draft of amendments to the *IFRS for SMEs* Standard.⁵

Staff analysis

13. Following the IASB's tentative decision in November 2021, this section of the paper presents the staff analysis on:
- (a) approaches to amending recognition and measurement requirements for development costs for SMEs—including SMEIG recommendations on the identified approaches (paragraphs 14–26 of this paper); and
 - (b) applying the alignment principles to the recognition and measurement of developments costs for SMEs (paragraphs 27–43 of this paper).

² See paragraphs BC213–BC214 of the Basis for Conclusions on the *IFRS for SMEs* Standard.

³ See [AP8D of the April 2013 IASB meeting](#) and the [IASB Update April 2013](#).

⁴ See [Agenda Paper 8 of the September 2021 SMEIG meeting](#) and the [SMEIG meeting report September 2021](#).

⁵ See [AP30E of the November 2021 IASB Meeting](#) and the [IASB Update November 2021](#).

Approaches to amending recognition and measurement requirements for development costs for SMEs—including SMEIG recommendations on the identified approaches

14. The staff think there are two possible approaches to amending the recognition and measurement requirements for development costs in the *IFRS for SMEs* Standard the IASB may consider:
- (a) permitting an SME to recognise as intangible assets the development costs meeting similar criteria to those in IAS 38, by introducing an accounting policy option (see paragraphs 16–21 of this paper); or
 - (b) requiring an SME to recognise as intangible assets the development costs meeting similar criteria to those in IAS 38 unless there is undue cost or effort, that is providing an undue cost or effort exemption (see paragraphs 22–26 of this paper).
15. The SMEIG met on 21 January 2022 to discuss these possible approaches and develop recommendations for the IASB. SMEIG members generally agreed that the IASB should propose amendments to the recognition and measurement requirements for development costs in the *IFRS for SMEs* Standard to permit, but not require, an SME to recognise development costs as intangible assets—that is either by introducing an accounting policy option or by introducing a requirement with an undue cost or effort exemption.⁶ SMEIG recommendations are set out in paragraphs 19–23 of this paper.

As an accounting policy option

16. The staff think the IASB could propose amendments to the *IFRS for SMEs* Standard introducing an accounting policy option permitting an SME to either recognise development costs as intangible assets or expense them. An SME that chooses to

⁶ See [Agenda Paper 5 of the January 2022 SMEIG meeting](#).

recognise development costs as intangible assets would apply requirements similar to those in paragraph 57 of IAS 38.

17. The staff think permitting an SME an accounting policy option to recognise development costs as intangible assets for all such costs (that is, not on a project-by-project basis):
- (a) would enable SMEs capable of assessing the commercial viability of their development activities to recognise intangible assets arising from development costs;
 - (b) would enable SMEs that would not benefit from incurring the ongoing cost of assessing the commercial viability of development activities to opt to expense development costs as incurred; and
 - (c) would enable SMEs to balance the costs and benefits of recognising development costs as intangible assets, meeting the information needs of users of their financial statements without imposing unnecessary burden on SMEs.
18. However, the staff note that the IASB observed that introducing accounting policy options in the *IFRS for SMEs* Standard would:
- (a) increase complexity of the *IFRS for SMEs* Standard;⁷
 - (b) reduce comparability between SMEs;
 - (c) generally increase cost for both preparers and users of SMEs financial statements;⁸ and
 - (d) result in more accounting policy options than in IFRS Accounting Standards.⁹
19. The majority of SMEIG members agreed that the IASB should permit an SME to recognise as intangible assets development costs meeting similar criteria to those in IAS 38, as an accounting policy option. These SMEIG members said:
- (a) an accounting policy option would be easier to apply in practice because it would require less judgement than requiring recognition of development

⁷ See paragraphs BC208–BC209 of the Basis for Conclusions on the *IFRS for SMEs* Standard.

⁸ See paragraphs BC208–BC209 of the Basis for Conclusions on the *IFRS for SMEs* Standard.

⁹ See paragraph BC214 of the Basis for Conclusions on the *IFRS for SMEs* Standard.

costs as intangible assets with an undue cost or effort exemption. Therefore, it would be consistent with the objective of keeping the *IFRS for SMEs* Standard simple.

- (b) intangible assets arising from development costs represent a significant asset class for some SMEs. Such SMEs should, therefore, be given the option to recognise some development costs as intangible assets to ensure they are faithfully represented.
20. One SMEIG member who supported introducing an accounting policy option for development costs, suggested the staff consider:
- (a) the likelihood for SMEs to utilise the accounting policy option, if provided, as in some jurisdictions there may be greater tax benefits in expensing development costs; and
 - (b) possible simplifications to the criteria for recognising development costs as intangible assets in IAS 38, because these criteria may be complex for SMEs.
21. Two SMEIG members also shared positive feedback from their respective jurisdictions on the accounting policy option available in their local GAAP to recognise intangible assets arising from development costs.

Requiring recognition of intangible assets with an undue cost or effort exemption

22. One SMEIG member opposed introducing an accounting policy option permitting an SME to recognise development costs as intangible assets because such an option may lead to unfaithful representation (if SMEs have development costs meeting the criteria as per IAS 38 and opt not to exercise the accounting policy option) and may be used as a tax-manipulation tool. This SMEIG member supported the alternative approach of amending the *IFRS for SMEs* Standard to require an SME to recognise intangible assets arising from development costs meeting similar criteria to those in IAS 38 and provide an undue cost or effort exemption to balance the costs and benefits of such a requirement.

23. Another SMEIG member said that, although requiring an SME to recognise intangible assets arising from development costs that meet similar criteria to those in IAS 38 with an undue cost or effort exemption is a sound approach theoretically, applying an undue cost or effort exemption would, in practice, require judgement.
24. Under this approach, the undue cost or effort exemption would apply to the process of assessing the development costs against the criteria, with two possible outcomes:
- (a) if recognition of development costs as intangible assets can be assessed on an ongoing basis without undue cost or effort, SMEs would be required to recognise and measure development costs on a basis aligned to IAS 38.
 - (b) if recognition of development costs as intangible assets cannot be assessed on an ongoing basis without undue cost or effort, SMEs would continue to expense development costs when incurred as currently required by paragraph 18.14 of the *IFRS for SMEs* Standard.
25. Introducing a requirement to recognise intangible assets arising from development costs meeting similar criteria to those in IAS 38 with an undue cost or effort exemption, rather than as an accounting policy, is consistent with the IASB's aim to limit accounting policy options in other parts of the *IFRS for SMEs* Standard.
26. As per paragraph 2.14B of the *IFRS for SMEs* Standard, an undue cost or effort exemption relates to the effort associated with obtaining or determining the information necessary to comply with a requirement, dependent on each SME's specific circumstances and management's judgement of the cost.

Applying the alignment principles to the recognition and measurement of development costs for SMEs

27. As part of the second comprehensive review, the IASB tentatively decided to apply three 'alignment principles' in considering whether and, if so, how to align the *IFRS for SMEs* Standard with new and amended IFRS Accounting Standards. The three principles are 'relevance to SMEs', 'simplicity' and 'faithful representation'.
28. Although IAS 38 is not a new or amended IFRS Accounting Standard, the staff think those three principles could assist the IASB in deciding whether to propose

amendments to the recognition and measurement of development costs. This section of the paper therefore assesses the potential for amending the recognition and measurement requirements for development costs applying the principles of relevance to SMEs, simplicity and faithful representation.

Relevance to SMEs

29. The *Conceptual Framework for Financial Reporting* sets out relevant financial information as information capable of making a difference in the decisions made by users. In this context, the staff are of the view that recognising intangible assets arising from development costs that meet specified criteria would be relevant to SMEs as they provide useful information about SMEs business models and expected future cash-flow to users, whilst upholding the principle of faithful representation amongst others. This is further supported by feedback on the Request for Information which states the inability to recognise intangible assets arising from development costs has affected user's evaluation of SMEs.¹⁰
30. As noted in paragraph 10 of this paper, paragraphs BC113–BC114 of the Basis for Conclusions on the *IFRS for SMEs* Standard set out the IASB's basis for requiring SMEs to expense all development costs when incurred. However, in November 2021, the IASB tentatively decided to reassess the basis for prohibiting recognition of development costs as intangible assets in the *IFRS for SMEs* Standard. In September 2021, a SMEIG member also said that SMEs today, especially those engaged in significant research and development activities as their primary business, are likely to be able to assess whether a project is commercially viable on an ongoing basis. Additionally, the staff note that recognition of development costs as intangible assets would also benefit users such as lenders. Feedback from outreach with lenders indicated the need to understand SMEs business models and sustainability of business models when making lending decisions. The staff think the recognition of development costs as intangible assets would improve information made available to lenders on the sustainability of revenue streams and completeness of business models of SMEs in making lending decisions. In summary, the staff think this feedback

¹⁰ See [comment letter 40](#) on the *Comprehensive Review of the IFRS for SMEs Standard* October 2020.

suggests that the recognition of development costs as intangible assets today is relevant to SMEs and would benefit users of SMEs financial statements in decision making.

31. Further, the staff note that the feedback on the IASB's Third Agenda Consultation includes calls for the IASB to undertake a comprehensive review of IAS 38 to better reflect the increasing importance of intangible assets in today's business models, particularly for unrecognised internally generated assets.¹¹ In the staff's view, this feedback indicates that the holding of intangible assets is becoming more prevalent among entities today, and continuing to prohibit the recognition of intangible assets arising from development costs in the *IFRS for SMEs* Standard is not consistent with ensuring relevant financial information is made available to users of SMEs financial statements, in the light of the evolving digital economy.
32. Finally, the staff note that requiring an SME to recognise development costs as intangible assets would address feedback from the Request for Information that said the limitation on recognition of development costs as intangible assets may have deterred jurisdictions and/or individual entities from adopting and/or applying the *IFRS for SMEs* Standard.
33. Therefore, the staff think the recognition of development costs as intangible assets would be relevant to SMEs, especially SMEs engaged in research and development activities, given these types of SMEs may be increasingly prevalent in the light of the evolving digital economy.

Simplicity

34. Paragraph 57 of IAS 38 states that an intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate its fulfilment of all criteria set out in paragraphs 57(a)–(f) of IAS 38.
35. The staff note that aligning the recognition and measurement of development costs in the *IFRS for SMEs* Standard with IAS 38 would require SMEs to assess on an

¹¹ See [AP24D of the November 2021 IASB Meeting](#) and the [IASB Update November 2021](#).

- ongoing basis whether the costs fulfil all six criteria set out in paragraphs 57(a)–(f) of IAS 38.
36. The staff think requiring all SMEs to assess all six criteria in IAS 38 on an ongoing basis would impose burden on SMEs, especially those that have limited research and development activities. Therefore, the staff think that the IASB would need to apply the undue cost or effort exemption to the process of assessing the criteria in IAS 38. This would save on costs if it is clear to an SME that the assessment itself would be time-consuming.
37. On the other hand, for an SME, applying an accounting policy option may be simpler in practice compared to assessing all six criteria in IAS 38 on an ongoing basis. However, the staff think that continuing to limit accounting policy options within the *IFRS for SMEs* Standard is consistent with the simplicity principle because the IASB has noted that although SMEs could still choose to apply the simpler option, introducing accounting policy options nevertheless still adds complexity to the *IFRS for SMEs* Standard.
38. The staff also note that retaining the *IFRS for SMEs* Standard requirement to expense all development costs is consistent with the simplicity principle. This approach would minimise costs of preparing financial statements for SMEs and ultimately maintain the simple application of the *IFRS for SMEs* Standard. This is in line with the IASB's acknowledgement of the different user needs of SMEs financial statements and SMEs limitations in, and cost of accounting expertise available to SMEs.¹² This viewpoint relies on the view that requiring recognition of development costs as intangible assets is complex and thereby choosing not to include the requirement is a simplification in the *IFRS for SMEs* Standard.
39. Accordingly, the staff think retaining the *IFRS for SMEs* Standard requirement to expense all development costs when incurred best ensures that the simple application of the *IFRS for SMEs* Standard is maintained. However, the staff are of the view that if the IASB were to propose amending the *IFRS for SMEs* Standard requiring SMEs to recognise as intangible assets the development costs meeting similar criteria to

¹² See paragraph BC47 of the Basis for Conclusions on the *IFRS for SMEs* Standard.

those in IAS 38, introducing a requirement to recognise these costs as an asset best achieves faithful representation, while allowing an undue cost or effort exemption maintains suitable simplicity.

Faithful representation

40. Faithful representation refers to depicting phenomena in financial statements in a manner that is complete, neutral and free from error.¹³ In the staff's view, aligning the recognition of development costs meeting specified criteria as intangible assets with IAS 38 would attain the faithful representation objective—that is to faithfully represent both the relevant phenomena and substance of the phenomena arising from development costs.
41. Consistent with the principle of faithful representation, the staff think aligning the *IFRS for SMEs* Standard with IAS 38 for the recognition of intangible assets arising from development costs might encourage disclosure of forward-looking voluntary information to users of SMEs financial statements even when recognition criteria are not fulfilled, as the recognition criteria include gathering substantial information about project feasibility and commercial viability, which can be used to compile disclosures.¹⁴ Improved disclosures and information on SMEs development costs made available would enable users to develop a better understanding of SMEs profitability, business model and future cash-flows.
42. However, the staff think permitting (as an accounting policy option) an SME to recognise development costs as intangible assets would not lead to similar benefits discussed in paragraphs 40–41 of this paper. Introducing a requirement, rather than an accounting policy option, in the *IFRS for SMEs* Standard achieves faithful representation in a similar way to IAS 38 because it removes the possibility described in paragraph 22 of this paper that an SME might choose an option which is not

¹³ See paragraphs 2.12–2.19 of the *Conceptual Framework for Financial Reporting*.

¹⁴ Chen, Ester and Gavius, Ilanit and Lev, Baruch Itamar, *The Positive Externalities of IFRS R&D Capitalization: Enhanced Voluntary Disclosure* (November 23, 2016). *Review of Accounting Studies*, Forthcoming. Available at SSRN: <https://ssrn.com/abstract=2874953>

appropriate for faithful representation, by choosing not to recognise development costs that meet the definition of an asset.

43. Although the staff note that introducing a requirement to recognise as intangible assets the development costs meeting specified criteria would best achieve faithful representation, the staff think an absolute requirement as per IAS 38 would impose burden on SMEs as discussed in paragraph 36 of this paper. The staff think introducing a requirement while allowing an undue cost or effort exemption would balance the principles of simplicity and faithful representation for SMEs.

Staff recommendation and question for the IASB

44. In the light of the staff analysis and recommendations from the SMEIG in this paper, the staff recommend the IASB seek views, in the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard, on requiring an SME to recognise intangible assets arising from development costs meeting the criteria in paragraphs 57(a)–(f) of IAS 38 with an undue cost or effort exemption.

Question for the IASB

Does the IASB agree to seek views, in the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard, on requiring an SME to recognise intangible assets arising from development costs meeting the criteria in paragraphs 57(a)–(f) of IAS 38 with an undue cost or effort exemption?