STAFF PAPER

May 2022

IASB® meeting

Project	**Second Comprehensive Review of the *IFRS for SMEs*® Accounting Standard**
Paper topic	Towards an exposure draft—review for inconsistencies between revised Section 2 and other Sections of the *IFRS for SMEs* Accounting Standard

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Purpose of the paper

1. This paper summarises the findings from the review for inconsistencies between:[1] [2]

   (a) Section 2 *Concepts and Pervasive Principles* of the *IFRS for SMEs* Accounting Standard (Standard) that the International Accounting Standards Board (IASB) tentatively decided to propose to amend to align it with the 2018 *Conceptual Framework for Financial Reporting* (2018 *Conceptual Framework*); and

   (b) other Sections of the Standard—after considering all of the IASB's tentative decisions to propose amendments to the Standard as part of this comprehensive review of the Standard.

[1] A summary of the IASB's tentative decisions to date is included in Agenda Paper 30 *Cover paper* of this meeting.

[2] This paper summarises the potential inconsistencies that have come to the staff's attention. Some of the inconsistencies identified in this paper have already been highlighted in papers for earlier IASB meetings.

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2. In this paper:

   (a) the term SMEs refers to small and medium-sized entities that are eligible to apply the Standard.

   (b) the term ‘revised Section 2’ refers to the staff draft of a revised Section 2 aligning with the 2018 *Conceptual Framework*.

   (c) the term ‘amended Section 19’ refers to the staff draft of an amended Section 19 including all of the changes that the IASB has tentatively decided to propose.

   (d) the review for inconsistencies is based on a staff draft of a revised Section 2. If during the balloting process changes are made to the staff draft of Section 2 that affect the analysis in this paper, staff will bring a sweep issue to an IASB meeting.

Summary of staff recommendations

3. The staff recommend the IASB propose amendments to the Standard to:

   (a) include the 1989 *Framework’s* definitions of an asset and a liability in Section 21 *Provision and Contingencies* and Section 18 *Intangible Assets other than Goodwill*, respectively, as discussed in paragraphs 13–14 of this paper; and

   (b) remove the references to the recognition criteria in Section 2 from Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill* as discussed in paragraph 46 of this paper.

Structure of the paper

4. This paper is structured as follows:

   (a) background (paragraphs 5–8 of this paper);

   (b) staff analysis (paragraphs 9–46 of this paper); and

(c) staff conclusion (paragraph 47 of this paper).

Background

5. Section 2 of the *IFRS for SMEs* Accounting Standard is based on the *Framework for the Preparation and Presentation of Financial Statements* issued in 1989 (1989 *Framework*). Section 2 is part of the Standard and the concepts and basic principles in Section 2 have equal authority with other Sections of the Standard.

6. At its May 2021 meeting, the IASB tentatively decided to propose:[3]

   (a) retaining Section 2 as part of the Standard;

   (b) aligning Section 2 with the 2018 *Conceptual Framework*;

   (c) emphasising that the requirements in the other Sections of the Standard take precedence over revised Section 2;

   (d) undertaking a review for potential inconsistencies between revised Section 2 and other Sections of the Standard when the IASB has completed its deliberations on proposed amendments to the Standard; and

   (e) retaining the concept of 'undue cost or effort'.

7. Agenda Paper 30B *Towards an Exposure Draft—2018 Conceptual Framework* of the May 2021 IASB meeting also noted that:[4]

   (a) the inconsistencies between IFRS Accounting Standards and the 2018 *Conceptual Framework* could transpose to the equivalent Sections of the Standard if Section 2 is aligned with the 2018 *Conceptual Framework*.

   (b) the IASB could adopt the approach it applied in IFRS Accounting Standards when it issued the 2018 *Conceptual Framework*; that is any changes to

[3] For more detail of the IASB's tentative decisions see IASB Update May 2021.

[4] See paragraphs 40–48 and Appendix A of Agenda Paper 30B of the May 2021 IASB meeting AP30B: Towards an Exposure Draft—2018 *Conceptual Framework*. Staff preliminary responses were provided in Appendix A of that paper.

revised Section 2 would not automatically lead to changes in other Sections of the Standard, but, if necessary, clarifications could be proposed to the other Sections (see paragraph 6(c) of this paper).

8. Accordingly, the staff analysis in this paper discusses:

    (a) the inconsistencies in Agenda Paper 30B of the May 2021 IASB meeting; and

    (b) additional inconsistencies that the staff have identified, after considering all of the IASB's tentative decisions in this comprehensive review that result in proposed amendments to the Standard.

Staff analysis

9. As discussed in paragraph 8 of this paper, the combine list of inconsistencies is:

    (a) IAS 32 *Financial Instruments:* Presentation (paragraphs 10–12 of this paper)*;*

    (b) quotes of existing definitions (paragraphs 13–14 of this paper);

    (c) IAS 19 *Employee Benefits* (paragraph 15 of this paper);

    (d) IFRIC 21 *Levies* which interpreted the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (paragraph 16 of this paper);

    (e) faithful representation versus reliability (paragraphs 17–21 of this paper); and

    (f) IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (paragraphs 22–26 of this paper);

    (g) aligning with IFRS 3 *Business Combinations* (paragraphs 27–35 of this paper);

    (h) deferring alignment with IFRS 16 *Leases* (paragraphs 36–42 of this paper); and

(i) other potential inconsistencies (paragraphs 43–46 of this paper).

IAS 32 Financial Instruments: *Presentation*

10. Some of the classification requirements of IAS 32 are inconsistent with the 2018 *Conceptual Framework*'s definitions of liability and equity. Equivalent Sections in the Standard (Section 22 *Liabilities and Equity* and Glossary of terms) have the same requirements as IAS 32.

11. In developing the 2018 *Conceptual Framework*, the IASB decided not to propose changes to the definitions that might eliminate the inconsistencies because the IASB has a project underway, *Financial Instruments with Characteristics of Equity*, that is exploring how to distinguish liabilities from equity claims. If necessary, the 2018 *Conceptual Framework* will be updated as one possible outcome of that project.

12. The staff think that the Standard should not bypass the IFRS Accounting Standards, therefore the staff have not tried to eliminate such inconsistencies for this review of the Standard.

Quotes of existing definitions

13. IAS 37 includes the 1989 *Framework* definition of a liability. IAS 38 *Intangible Assets* includes the 1989 *Framework* definition of an asset. Both Standards were not amended following the revision of the definitions in 2018 *Conceptual Framework*. Equivalent Sections in the Standard (Section 21 *Provision and Contingencies* and Section 18 *Intangible Assets other than Goodwill*) do not include the definitions of an asset and a liability. In developing the Exposure Draft of the Third edition of the Standard, as noted in Appendix A to Agenda Paper 30B

of the May 2021 IASB meeting, the staff consider including the definitions of an asset and a liability in Section 18 and Section 21.[5]

14. The staff think that adding the *1989 Framework* definitions of an asset and of a liability to Section 18 and Section 21, respectively, would ensure there are no unintended consequences.

IAS 19 Employee Benefits

15. IAS 19 requires disclosure of expected contributions (see paragraphs 147–148 of IAS 19) and is inconsistent with the forward-looking information approach in the 2018 *Conceptual Framework*. Section 28 *Employee Benefits* does not require disclosure of expected contributions, therefore the staff think that no action is needed.

IFRIC 21 Levies

16. IFRIC 21 clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. However, the requirements of IAS 37 as interpreted in IFRIC 21 are inconsistent with the concepts for identifying liabilities in the 2018 *Conceptual Framework*. At its December 2021 meeting, the IASB tentatively decided not to align the Standard with IFRIC 21.[6] Therefore, no inconsistency on identifying liabilities on the obligating event that gives rise to a levy will be introduced to Section 21 of the Standard.

[5] See Appendix A to Agenda Paper 30B of the May 2021 IASB meeting AP30B: Towards an Exposure Draft—2018 *Conceptual Framework*.

[6] See December 2021 IASB paper AP30J: *Towards and Exposure Draft—Amendments to IFRS Standards and IFRIC Interpretations (topics with no amendments recommended)*

Faithful representation versus reliability

17. The 1989 *Framework* used the term 'reliability' to describe what is called faithful representation in the 2018 *Conceptual Framework*. The term 'reliability' is not reinstated as a qualitative characteristic in the 2018 *Conceptual Framework*. However, some existing IFRS Accounting Standards still use the term 'reliability'.

18. At its October 2014 meeting, the IASB discussed whether the use of the term 'reliability' needs to be clarified in full IFRS Accounting Standards. The IASB noted that the notion of reliability was used in two different ways in full IFRS Accounting Standards:[7]

    (a) to mean that the level of measurement uncertainty is tolerable. This use of the word reflects the recognition criteria included in the 1989 *Framework*—an item that meets the definition of an element is recognised only if it is probable there will be a flow of economic benefits and it has a cost or value that can be measured with reliability.

    (b) to refer to a qualitative characteristic of useful financial information—the characteristic previously called 'reliability' and now called 'faithful representation'. This use of reliability is much less frequent in full IFRS Accounting Standards.

19. The IASB considered that it would be too difficult to identify throughout full IFRS Accounting Standards when the term 'reliability' was being used in the broader sense of 'faithful representation' or the narrower sense of 'measurement uncertainty', and such changes would be likely to be controversial in full IFRS Accounting Standards. Therefore, the IASB decided not to propose amendments to other Standards to replace the term 'reliability' with the term 'faithful representation'.

[7] See paragraph BC2.29 of the 2018 *Conceptual Framework*.

20. The Standard has the similar use of reliability:

    (a) to mean that the level of measurement uncertainty is tolerable. This use of the word reflects the recognition criteria included in Section 2—an item that meets the definition of an element is recognised only if it is probable there will be a flow of economic benefits and it has a cost or value that can be measured or estimated with reliability.

    (b) to refer to a qualitative characteristic of useful financial information—the characteristic currently called 'reliability' in Section 2, which would be called 'faithful representation' in revised Section 2. This use of reliability is not frequently seen in other sections of the Standard.

21. Applying the similar approach to full IFRS Accounting Standards, the staff think it is not necessary to replace the term 'reliability' with the term 'faithful representation' in the other Sections of the Standard.

IAS 1 Presentation of Financial Statements *and IAS 8* Accounting Policies, Changes in Accounting Estimates and Errors

22. At its November 2016 meeting, the IASB discussed the potential effects on preparers' accounting policies of replacing references to the 1989 *Framework* with references to the 2018 *Conceptual Framework* in IAS 8,[8] and indicated that the scope of any changes to preparers' accounting policies as a result of updating the reference is likely to be limited.

23. At its January 2017 meeting, the IASB discussed the amendments to IAS 1 and IAS 8. The IASB decided to confirm the proposals in the Exposure Draft *Updating References to the Conceptual Framework* to replace references to the

[8] For more detail of the IASB's discussion, see Agenda Paper 10G *Effects of the proposed changes to the Conceptual Framework on Preparers* of the November 2016 IASB meeting.

1989 *Framework* in IAS 1 and IAS 8 with references to the 2018 *Conceptual Framework*. No other amendments to IAS 1 and IAS 8 were made.[9]

24. The staff have reviewed the equivalent sections of the Standard and identified that: [10]

    (a) Section 3 *Financial Statement Presentation* requires the fair presentation of financial statements in accordance with the definitions, recognition criteria and objective of financial statements of SMEs set out in Section 2; and

    (b) Section 10 *Accounting Policies, Estimates and Errors* requires management to refer to definitions, recognition criteria and measurement concepts, and pervasive principles in Section 2 in making their judgements.

25. The staff think that the scope of likely effect is limited, similar to the previous findings in updating the reference to 2018 *Conceptual Framework* as stated in paragraph 22 of this paper this is because Section 3 and Section 10 are aligned with IAS 1 and IAS 8 respectively.

26. Therefore, the staff recommend retaining the requirements in these Sections. Furthermore, the override paragraph the IASB has tentatively decided to include in Section 2 (see paragraph 6(c) of this paper) will address any inconsistencies that do arise in practice between revised Section 2 and these Sections.

Aligning with IFRS 3 Business Combinations

1—Recognition conditions

27. Section 19 *Business Combinations and Goodwill* is currently based on IFRS 3 (2004) which carries forward the general principle previously in IAS 22 *Business*

[9] For more detail of the IASB's decisions see the [January 2017 IASB *Update*].

[10] The equivalent Sections to IAS 1 *Presentation of Financial Statements* are Section 3 *Financial Statement Presentation*, Section 4 *Statement of Financial Position*, Section 5 *Statement of Comprehensive Income and Income Statement*, Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings* and Section 8 *Notes to the Financial Statements*. The equivalent Section to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Error* is Section 10 *Accounting Policies, Estimates and Errors*.

Combinations. That principle required an acquirer to recognise separately, from the acquisition date, the acquiree's identifiable assets and liabilities at that date that can be measured reliably and for which it is probable that any associated future economic benefits will flow to, or resources embodying economic benefits will flow from, the acquirer.

28. In contrast, IFRS 3, as amended in May 2020, states that to qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed needed to meet the definitions of assets and liabilities in the 2018 *Conceptual Framework.*

29. In developing the Exposure Draft of the Third edition of the Standard the staff have identified that amended Section 19 is not aligned with the requirements in IFRS 3 as amended in May 2020 and that there could be an inconsistency between amended Section 19 and revised Section 2. This is because, changing the recognition principles and the definitions (including the supporting concepts) could change which assets and liabilities qualify for recognition in a business combination.

30. Consequently, the staff think the IASB could address such inconsistency by proposing a further amendment to amended Section 19 to align with IFRS 3 as amended in May 2020—so that to qualify for recognition, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in revised Section 2 at the acquisition date. In Agenda Paper 30D of this meeting, the staff recommend the IASB propose to update the reference in amended Section 19.

2—Exceptions to the acquisition method (measuring non-controlling interests, and therefore goodwill as set out in IFRS 3)

31. At its December 2021 meeting, the IASB tentatively decided to retain the requirement in Section 19 that an entity measure any non-controlling interest in the acquiree at the non-controlling interest's proportionate share of the recognised

amounts of the acquiree's identifiable net assets—therefore not introducing the option to measure non-controlling interests at fair value.[11]

32. The reporting entity perspective to be proposed in revised Section 2 is inconsistent with the requirement to recognise goodwill from the parent's perspective under amended Section 19 (sometimes called the proportionate share method), because the option to measure non-controlling interests at fair value has not been introduced.

33. The staff note that goodwill recognised in a business combination is a residual amount that among other things depends on measurement of non-controlling interests. Measuring non-controlling interests at the proportionate share of the acquiree's identifiable net assets results in recognition of the parent-only share of goodwill (not the full goodwill method). However, such treatment is optional applying IFRS 3 and effectively represents an exception to the measurement principle in IFRS 3.

34. The staff believe that the inconsistency, as set out in paragraph 32 of this paper, would not be identified as a substantive inconsistency that would cause any practical problems applying either revised Section 2 or amended Section 19, because:

    (a) it was noted in the IASB's December 2021 discussions that some IASB members did not support allowing that option because it would introduce complexity in the Standard and be more costly than measuring the non-controlling interests at its proportionate share of the acquiree's identifiable net assets, therefore not introducing the option is a simplification and is supported as the cost of measuring non-controlling interests at fair value may outweigh the benefit for SMEs; and

    (b) the measurement principle in amended Section 19 requires recognition in full of the identifiable assets acquired and the liabilities assumed at their acquisition date fair values (except for simplifying the acquisition method of

[11] For more detail of the IASB's tentative decisions see IASB Update December 2021.

accounting by not changing the criteria for recognising intangible assets acquired in a business combination) and that principle is consistent with the reporting entity perspective that is discussed in the revised Section.

35. In addition, the *Invitation to Comment* of the Exposure Draft will ask for feedback on whether:

(a) to retain the requirements of amended Section 19—so that an SME measures any non-controlling interest in the acquiree at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets; or

(b) to amend Section 19 (to align with IFRS 3) to permit an SME to choose—on a transaction-by-transaction basis—whether to measure any non-controlling interest in an acquiree:

(i) at its fair value; or

(ii) as the non-controlling interests' proportionate share of the recognised amount of the acquiree's identifiable net assets.

Deferring alignment with IFRS 16 **Leases**

36. At its November 2021 meeting, the IASB tentatively decided to retain Section 20 *Leases* unchanged and to consider amending the Standard to align with IFRS 16 in a future review of the Standard.[12]

37. Following the IASB's tentative decision in paragraph 36 of this paper, the staff have identified the requirement for lessees not to recognise a right-of-use asset (and corresponding obligation in respect of operating leases) as potential inconsistency with the proposed definitions of an asset (and of a liability) and with revised Section 2, particularly the criterion of there being a present obligation.

[12] For more detail of the IASB's tentative decisions see IASB Update November 2021.

38. The staff note that, in developing IFRS 16, the IASB concluded that:[13]

(a) the lessee's right to use an underlying asset meets the 2018 *Conceptual Framework* definitions of an asset; and

(b) the lessee's obligation to make lease payments meets the 2018 *Conceptual Framework* definitions of a liability.

39. However, the staff note that in the IASB's November 2021 discussions, non-aligning Section 20 with the IFRS 16 model was not the IASB's original preference. The IASB's discussions put greater emphasis on cost-benefit considerations and on allowing more time to assess the implementation of IFRS 16, in particular the reasons behind this tentative decision were that:

(a) the post-implementation review of IFRS 16 has not yet been performed.

(b) the findings from this review may provide additional information about the costs and benefits of introducing the single accounting model of IFRS 16 into the Standard, and may give assurance that IFRS 16 is working as intended and will not be amended; and

(c) the appropriate timing for incorporating IFRS 16 requirements into the Standard should be weighed against the need to balance benefits to users with cost and effort for preparers.

40. Revised Section 2 states that the cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting additional financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information.

41. The staff acknowledge the IASB's views that the costs and efforts for preparers to apply IFRS 16 requirements (at this stage of IFRS 16's life cycle) could not be justified by the benefits of reporting additional financial information in accordance with IFRS 16 requirements to users—given paragraph 40 of this paper, and therefore the staff think that the non-recognition of operating leases as lessee's right

[13] See paragraphs BC22–BC34 of the Basis for Conclusions on IFRS 16.

to use an underlying asset (and lessee's obligation to make lease payments) might be largely not inconsistent with revised Section 2.

42. The *Invitation to Comment* will seek additional information on cost-benefit considerations, on whether:

   (a) aligning Section 20 with IFRS 16 imposes a workload on SMEs disproportionate to the benefit to users of financial statements:

      (i) the costs that preparers of financial statements could incur;

      (ii) the costs that users of financial statements could incur when information is not available; and

      (iii) the benefit of having the lessee's right to use an underlying asset (and lessee's obligation to make lease payments) on balance sheet in which it could improve the financial reporting.

   (b) introducing possible simplifications—for example on the discount rate—could help to streamline requirements and thereby reduce or eliminate the cost of IFRS 16 application.

Other potential inconsistencies

43. The staff have considered other potential inconsistencies and have identified that the recognition requirements in following Sections of the Standard repeat the recognition criteria in the existing Section 2:

   (a) Section 17 *Property, Plant and Equipment*;

   (b) Section 18 *Intangible Assets other than Goodwill*;

   (c) Section 21 *Provisions and Contingencies*; and

   (d) Section 34 *Specialised Activities: Agriculture*.

44. Some recognition requirements in full IFRS Accounting Standards also repeat the recognition criteria from the 1989 *Framework*. At its October 2014 meeting, the IASB discussed the potential inconsistencies on these recognition requirements that

are based on 1989 *Framework* recognition criteria. The staff did not attempt to predict what would be the IASB's conclusion if it were to have revisited existing IFRS Accounting Standards as a consequence of the 2018 *Conceptual Framework*. The staff did not try to assess whether the IASB would have specified the same recognition criteria for those particular assets or liabilities if it had applied the concepts in the 2018 *Conceptual Framework*. Therefore, the repetitions of the recognition criteria were not listed as inconsistencies when the 2018 *Conceptual Framework* was issued.

45. Applying the approach used for full IFRS Accounting Standards, the staff think there is no need to list, as inconsistencies, the repetitions of the recognition criteria in those Sections of the Standard listed in paragraph 43 of this paper.

46. However, Section 17 and Section 18 include the paragraph references to the recognition criteria in existing Section 2. Therefore, in developing the Exposure Draft the staff recommend removing the references to Section 2 from Section 17 and Section 18.

Staff conclusion

47. In the light of the analysis above, the staff do not recommend any changes to the Standard as a consequence of the review for potential inconsistencies between revised Section 2 and other existing (or to be revised/amended) Sections, except for:

(a) including the 1989 *Framework's* definitions of an asset and a liability in Section 21 and Section 18, respectively, as discussed in paragraphs 13–14 of this paper; and

(b) removing the references to the recognition criteria in Section 2 from Section 17 and Section 18, as discussed in paragraph 46 of this paper.

Furthermore, the override paragraph to be included in revised Section 2 emphasises that the specific requirements of the other Sections of the Standard take precedence over the requirements in revised Section 2 and deal with potential inconsistencies.

Questions for the IASB

Questions for the IASB

1. Does the IASB agree with the staff recommendations to propose amendments to the Standard to:

   (a) include the 1989 *Framework's* definitions of an asset and a liability in Section 21 *Provision and Contingencies* and Section 18 *Intangible Assets other than Goodwill*, respectively, as discussed in paragraphs 13–14 of this paper; and

   (b) remove the references to the recognition criteria in Section 2 from Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*, as discussed in paragraph 46 of this paper.

2. Do IASB members have comments or questions on the review in this paper?