IFRS

STAFF PAPER

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IASB® meeting

Project	**Second Comprehensive Review of the *IFRS for SMEs®* Accounting Standard**
Paper topic	Towards an exposure draft–*IFRS for SMEs* Accounting Standard transition requirements for alignment with new IFRS Accounting Standards

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1. The International Accounting Standards Board (IASB) has tentatively decided to propose amendments to the *IFRS for SMEs* Accounting Standard. This paper discusses how entities applying the *IFRS for SMEs* Accounting Standard would initially apply the proposed amendments to align with new IFRS Accounting Standards in the scope of the second comprehensive review.

2. In this paper:

   (a) the term SMEs refers to small and medium-sized entities that are eligible to apply the *IFRS for SMEs* Accounting Standard; and

   (b) the term 'amended Section' or 'revised Section' of the *IFRS for SMEs* Accounting Standard refers to a staff draft of an amended or revised Section including the changes that the IASB has tentatively decided to propose.

Purpose of the paper

3. This paper discusses transition requirements for the *IFRS for SMEs* Accounting Standard arising from the IASB's tentative decisions to propose amendments to the Standard to align it with new IFRS Accounting Standards in the scope of the second comprehensive view.

Summary of staff recommendations

4. The staff recommendations are summarised in Appendix A to this paper. The recommendations use the transition requirements and reliefs of the new IFRS Accounting Standards as the starting point and supplement these with reliefs for SMEs.

Structure of this paper

5. Paragraphs 8–12 of this paper discuss the approach to developing transition requirements. For each section of the Standard that the IASB has tentatively decided to align with new IFRS Accounting Standards, the staff analysis in this paper is structured as follows:

Section of the *IFRS for SMEs* Accounting Standard	**Paragraphs of this paper**
Section 11 *Basic Financial Instruments*	13–22
Section 9 *Consolidated and Separate Financial Statements*	23–35
Section 15 *Investments in Joint Ventures*	36–41
Section 19 *Business Combinations and Goodwill*	42–44
Section 23 *Revenue*	45–63
New section *Fair Value Measurement*	64–66

6. The questions for the IASB are included at the end of the staff analysis for each section of the *IFRS for SMEs* Accounting Standard.

7. Appendix A to this paper includes a summary of the staff recommendations.

Approach to developing the transition requirements

8. The staff think that transition requirements and reliefs of new IFRS Accounting Standards can be used as the starting point to develop transition requirements to be proposed in the Exposure Draft of the Third Edition of the *IFRS for SMEs* Accounting Standard. This is because an SME should have at least the same transition reliefs the IASB provided to entities that transitioned to the new IFRS Accounting Standards that the *IFRS for SMEs* Accounting Standard is being aligned with.

9. The transition requirements in this paper have been developed by applying the approach in paragraph 8 of this paper and then assessing whether additional transition relief and/or transition disclosures are needed.

Requirements of the **IFRS for SMEs** *Accounting Standard for changes in accounting policies*

10. Paragraph 10.11(a) of the *IFRS for SMEs* Accounting Standard requires an entity to account for a change in accounting policy resulting from a change in the requirements of the Standard in accordance with the transition requirements, if any, specified in the change in the requirements.

11. Paragraph 10.13 of the *IFRS for SMEs* Accounting Standard states that, when an amendment to the Standard has an effect on the current period or any prior period, or might have an effect on future periods, an entity is required to disclose:

    (a) the nature of the change in accounting policy;

    (b) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;

    (c) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(d) an explanation if it impracticable to determine the amount to be disclosed in (b) or (c).

Paragraph 10.13 will apply when an SME initially applies the Third Edition of the *IFRS for SMEs* Accounting Standard.

12. Paragraph 10.12 of the *IFRS for SMEs* Accounting Standard states that, when a change in accounting policy is applied retrospectively but it is impracticable to determine the individual-period effects of a change in accounting policy on comparative information for one or more prior periods presented, an SME is required to apply the new accounting policy to the carrying amounts of assets and liabilities at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.

Section 11 *Basic Financial Instruments*

Amendments the IASB has tentatively decided to propose

13. The IASB has tentatively decided to propose amendments to Section 11 of the *IFRS for SMEs* Accounting Standard:

(a) to remove the option to apply the recognition and measurement requirements for financial instruments in IFRS Accounting Standards (the 'fallback' to IAS 39 *Financial Instruments: Recognition and Measurement*)*;*

(b) to supplement the examples in Section 11 with a principle for classifying financial assets based on their contractual cash flow characteristics (supplementary principle);

(c) to define 'financial guarantee contract' using the definition in IFRS 9 *Financial Instruments* and require the issuer to initially measure the contract at the premium received (plus the present value of any future premium payments receivable) and subsequently measure it at the higher of:

(i) expected credit losses; and

(ii) amount initially recognised, if any, amortised on a straight-line basis over the life of the guarantee.

(d) to require SMEs to use an expected credit loss model for financial assets measured at amortised cost except for trade receivables and contract assets within the scope of Section 23 *Revenue*.

Staff analysis

14. As the IASB has tentatively decided to propose removing the optional fallback to IAS 39 (see paragraph 13(a) of this paper), SMEs implementing the Third Edition of the *IFRS for SMEs* Accounting Standard can be segregated into two:

(a) SMEs transitioning from the recognition and measurement requirements of IAS 39 to the amended Section 11; and

(b) SMEs transitioning from the recognition and measurement requirements in Sections 11 and 12 to the amended Section 11.[1]

SMEs applying the optional fallback to IAS 39

15. For SMEs that are transitioning from the recognition and measurement requirements of IAS 39 to the amended Section 11, the staff think that SMEs would benefit from transitional relief from retrospective application, similar to that for financial instruments in Section 35 *Transition to the IFRS for SMEs*. This is because Section 35 applies to a first-time adopter of the *IFRS for SMEs* Accounting Standard regardless of whether its previous accounting framework was IFRS Accounting Standards or another set of generally accepted accounting principles.

[1] In the Third Edition of the *IFRS for SMEs* Accounting Standard, the staff expect to combine Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instrument Issues* into a single section renamed as Section 11 *Financial Instruments*.

16. Section 35 requires an entity on transition to the *IFRS for SMEs* Accounting Standard to recognise all assets and liabilities whose recognition is required by the Standard. Further, it contains transition reliefs for:

    (a) derecognition of financial assets and liabilities in paragraph 35.9(a) of the *IFRS for SMEs* Accounting Standard, which states that:

        (i) derecognised financial assets and liabilities shall not be recognised on adoption of the *IFRS for SMEs* Accounting Standard; and

        (ii) recognised financial assets and liabilities requiring derecognition on adoption of the *IFRS for SMEs* Accounting Standard can be either derecognised or continue to be recognised until disposed of or settled; and

    (b) hedge accounting.[2]

17. In addition to the reliefs discussed in paragraph 16 of this paper, the staff believe SMEs transitioning from IAS 39 would benefit from the following reliefs that the IASB provided to entities initially applying IFRS 9:

    (a) paragraph 7.2.3 of IFRS 9 requires an entity to assess classification of financial assets based on facts and circumstances at the date of initial application and apply the resulting classification retrospectively.

[2] Applying paragraph 35.9(b) of the *IFRS for SMEs* Accounting Standard, an entity shall not change its hedge accounting before the date of transition to the *IFRS for SMEs* Accounting Standard for hedging relationships that no longer exist at the date of transition. For hedging relationships that exist at the date of transition, the entity shall follow the hedge accounting requirements of Section 12 *Other Financial Instrument Issues* (which are being brought into the amended Section 11 unchanged), including the requirements for discontinuing hedge accounting for hedging relationships that do not meet the conditions of Section 12.

(b) paragraph 7.2.11 of IFRS 9 states that if it is impracticable for entities to apply the effective interest method retrospectively an entity is required to treat:

(i) fair value of the financial asset or financial liability at the end of each comparative period presented as the gross carrying amount of that financial asset or amortised cost of that financial liability; and

(ii) fair value of the financial asset or financial liability at the date of initial application as the deemed gross carrying amount of that financial asset and deemed amortised cost of that financial liability at that date.

SMEs applying Section 11 and 12

18. For the supplementary principle in paragraph 13(b) of this paper, the staff have identified two approaches for SMEs transitioning from Sections 11 and 12 of the Standard to the amended Section 11. The staff recommend the approach described in paragraph 18(a) of this paper (first approach) as the transition method for such SMEs:

(a) first approach—such SMEs would apply the supplementary principle retrospectively, subject to the impracticable exemption discussed in paragraph 12 of this paper. The principle supplements the existing guidance in Section 11 for classifying financial assets based on their contractual cash flow characteristics. The staff do not anticipate SMEs having to change their existing classification of financial assets on introduction of this supplementary principle, and therefore consider no transition relief necessary.

(b) second approach—such SMEs would apply the supplementary principle prospectively, which results in financial assets existing at the date of initial application not being reassessed for changes in classification. Only financial assets initially recognised on or after the date of initial application would be assessed applying the supplementary principle. The staff believe the supplementary principle acts as catch-all provision for SMEs that hold complex financial instruments, and that a retrospective change in classification (and with that remeasurement) would be burdensome for SMEs. However, the staff think it would be rare for an SME to hold complex financial instruments and not apply the optional fallback to IAS 39 for recognition and measurement of financial instruments. Hence, this transition relief would not necessarily affect comparability.

19. The transition relief corresponding to the amendments in paragraph 13(c) of this paper for issued financial guarantee contracts available when IFRS 9 was initially applied is not needed for SMEs because the accounting treatment for financial guarantee contracts to be proposed is based on simplified principles discussed in Agenda Paper 30B *Towards an Exposure Draft—IFRS 9 Financial Instruments (issued financial guarantee contracts)* of the March 2022 IASB meeting. In the staff's view the simplified accounting treatment can be applied retrospectively, subject to the impracticable exemption for SMEs discussed paragraph 12 of this paper.

20. The transition relief corresponding to the amendments in paragraph 13(d) of this paper for expected credit losses available when IFRS 9 was initially applied relates to the concept of significant increase in credit risk. This does not apply to the expected credit loss model to be proposed, which requires recognition of lifetime expected credit losses. Therefore, the staff believe the expected credit loss model to be proposed can be applied retrospectively, subject to the impracticable exemption for SMEs discussed paragraph 12 of this paper.

Staff recommendation

21. The staff recommend the IASB propose the following for entities transitioning from IAS 39:

    (a) require application of requirements in paragraph 35.9(a)–(b) of the *IFRS for SMEs* Accounting Standard for derecognition of financial assets and liabilities and hedge accounting;

    (b) require SMEs to assess classification of financial assets based on facts and circumstances that exist on the date of initial application under the amended guidance of Section 11 and apply the resulting classification retrospectively; and

(c) SMEs that find it impracticable to apply the effective interest method retrospectively, to treat the fair value of the financial asset or financial liability at the date of initial application and at the end of each prior period presented as gross carrying amount (deemed) for financial assets and amortised cost (deemed) for financial liabilities.

22. SMEs transitioning from Sections 11 and 12 to the amended Section 11 apply the amended Section 11 retrospectively, subject to the impracticable exemption for SMEs discussed paragraph 12 of this paper.

Question 1 for the IASB
Does the IASB agree with the staff recommendation to propose transition requirements in the *IFRS for SMEs* Accounting Standard as set out in paragraphs 21–22 of this paper, for Section 11?

Section 9 *Consolidated and Separate Financial Statements*

Amendments the IASB has tentatively decided to propose

23. The IASB has tentatively decided to propose amendments to Section 9 of the *IFRS for SMEs* Accounting Standard to align with IFRS 10 *Consolidated Financial Statements* by:

(a) aligning the control model as a single basis of control;

(b) retaining the simplification in paragraph 9.5 of the *IFRS for SMEs* Accounting Standard that control is presumed to exist when the parent entity owns (directly or indirectly) more than half of the voting power of an entity; and

(c) requiring a parent that loses control of a subsidiary to remeasure any retained interest in the former subsidiary at fair value.

Staff analysis

24. Paragraph 23(c) of this paper is a consequential amendment arising from amendments to Section 19 *Business Combinations and Goodwill*. The staff will bring a paper to the IASB on transition requirements for paragraph 23(c) of this paper at a future meeting.

25. When IFRS 10 was issued, the IASB included transition reliefs from retrospective application required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in relation both to consolidating investees that were not previously consolidated and no longer consolidating investees that were previously consolidated.

26. On initial application of IFRS 10 if an investor concludes it shall consolidate an investee that was not previously consolidated:

    (a) paragraph C4 of IFRS 10 requires the investor measures the assets, liabilities and non-controlling interests (including goodwill, if the investee is a business) as if the investees had been consolidated from the date the investee obtained control based on the definition of control in IFRS 10; and

    (b) if it is impracticable for the investor to apply the requirements in paragraph C4 of IFRS 10, paragraph C4A of IFRS 10 requires the investor applies the requirements of IFRS 3 as of the deemed acquisition date (including recognition of goodwill if the investee is a business). The deemed acquisition date is the beginning of the earliest period in which the application of the requirements is practicable, which could be the beginning of the current period.

27. In developing the transitional relief:

    (a) the IASB explained in paragraph BC196 of the Basis for Conclusions on IFRS 10 that when an investor consolidates investees previously accounted for using the equity method, information may often be available to consolidate investees retrospectively as if IFRS 10 had always been in place.

(b) the IASB explained in paragraph BC197 of the Basis for Conclusions on IFRS 10 that in some circumstances retrospective application would not be practicable and therefore the investor would be permitted to apply the transition relief of paragraph C4A of IFRS 10 (see paragraph 26(b) of this paper).

28. If applying IFRS 10 initially an investor concludes that it will no longer consolidate an investee:

(a) paragraph C5 of IFRS 10 requires that the investor measures its interest in the investee at the amount at which it would have been measured if the requirements in IFRS 10 had been effective when the investor became involved with the investee without obtaining control or losing control in the investee, based on the definition of control in IFRS 10; and

(b) when it is impracticable for the investor to apply the requirements in paragraph C5 of IFRS 10, paragraph C5A of IFRS 10 permits the investor to apply the requirements in IFRS 10 at the earliest date at which application is practicable, which could be the beginning of the current period.

29. Paragraph C3 of IFRS 10 states on initial application an entity is not required to make adjustments to its previous accounting for its involvement with either:

(a) entities that were consolidated both before and after initial application of IFRS 10; or

(b) entities that would not be consolidated according to the predecessor accounting standards and would not be consolidated applying IFRS 10.

The IASB explained in paragraph BC199A of the Basis for Conclusions on IFRS 10 that in this case the cost of retrospective application would exceed the benefit.

30. Paragraph C6A of IFRS 10 states that an investor is permitted to present comparative information only for the annual period immediately preceding the date of initial application, even where several years of comparatives are included in the financial statements. The IASB explained in paragraphs BC199C–BC199D of the

Basis for Conclusions on IFRS 10 that presenting all adjusted comparatives would be burdensome for preparers in jurisdictions where several years of comparatives are required.

31. In the staff's view, the arguments supporting the transitional reliefs in IFRS 10 apply to the amendments to be proposed to align the control model. The staff also note that applying the simplification in paragraph 23(b) of this paper, it is expected that there will be a fewer circumstances for which the assessment of control will change compared to when IFRS 10 was initially applied.

32. However, if an investor consolidates an investee that was previously accounted for as an associate in accordance with Section 14 *Investments in Associates*, the investor would not necessarily be applying the equity method to the investee but could apply either the cost model or the fair value model. An investor applying the cost model or the fair value is less likely to have information available to apply consolidation retrospectively.

Staff recommendations

33. The staff recommend the IASB propose the same transition requirements and relief that were provided for IFRS 10 as follows:

    (a) SMEs would not be required to make adjustments at the date of initial application of the amended Section 9 for either:

        (i) investees that would be consolidated both before and after the initial application of the amended Section 9; or

        (ii) investees that would not be consolidated both before and after initial application of amended Section 9.

    (b) if initial application of the amended Section 9 results in consolidating an investee not previously consolidated:

        (i) SMEs shall measure the assets, liabilities and non-controlling interests (including goodwill, if the investee is a business) as if the investees had been consolidated from the date control was obtained;

        (ii) if the application of the requirements in paragraph 33(b)(i) of this paper is impracticable, SMEs shall make adjustments from the earliest period doing such adjustments is practicable, which could also be the year of initial application.

(c) if initial application of the revised requirements results in no longer consolidating an investee previously consolidated:

(i) SMEs will apply the applicable requirements of *IFRS for SMEs* Accounting Standard retrospectively with the difference in carrying amounts adjusted in equity; and

(ii) if the application of the requirements in paragraph 33(c)(i) of this paper is impracticable, SMEs shall make such adjustments from the earliest period doing such adjustments is practicable, which could also be the year of initial application.

(d) an SME would be required to disclose quantitative impact for each financial statement line item affected for the annual period immediately preceding the date of initial application and not the current or earlier comparative periods (disclosure required by paragraph 10.13(b) of the *IFRS for SMEs* Accounting Standard).

34. The staff also recommend that the IASB add a transition requirement for when all the following conditions apply:

(a) SMEs deconsolidate investees previously consolidated;

(b) SMEs start accounting for the investees as associates applying the cost model; and

(c) it is impracticable to determine the cost of the original purchase.

35. The staff recommend that when these conditions apply, the IASB permits SMEs to measure the investment at deemed cost, being either:

(a) fair value at the date of initial application of the amended Section 9; or

(b) aggregate of the carrying amounts at the date of initial application of the amended Section 9 of the assets and liabilities, including goodwill, that SMEs had previously consolidated.

Question 2 for the IASB
Does the IASB agree with the staff recommendation to propose transition requirements in the *IFRS for SMEs* Accounting Standard as set out in paragraphs 33–35 of this paper, for Section 9?

Section 15 *Investments in Joint Ventures*

Amendments the IASB has tentatively decided to propose

36. The IASB has tentatively decided:

    (a) to propose amendments to Section 15 of the *IFRS for SMEs* Accounting Standard to align the definition of joint control in Section 15 with that in IFRS 11 *Joint Arrangements*.

    (b) to retain:

    (i) the classifications of joint arrangements: ‘jointly controlled operations’, ‘jointly controlled assets’ and ‘jointly controlled entities’; and

    (ii) the accounting requirements of Section 15, including the accounting policy election for jointly controlled entities.

    (c) to propose amendments to Section 15 of the *IFRS for SMEs* Accounting Standard to align the requirements of Section 15 with the requirements of paragraph 23 of IFRS 11 so that a party that does not have joint control of a jointly controlled operation or a jointly controlled asset would account for its interest according to the classification of that jointly controlled operation or the jointly controlled asset.

Staff analysis

37. When IFRS 11 was issued, the IASB provided reliefs mainly in relation to:

    (a) transition from applying proportionate consolidation to applying the equity method to interests in joint ventures (paragraphs C2–C6 of IFRS 11);

(b) transition from applying the equity method to accounting for assets and liabilities for interests in joint operations (paragraphs C7–C11 of IFRS 11).

38. The IASB also required transition disclosures of quantitative impact for each financial statement line item affected should be limited for the annual period immediately preceding the date of initial application. This disclosure is exempted for current or earlier comparative periods (disclosure required by paragraph 28(f) of IAS 8), since this requirement would be burdensome for a preparer.

Staff recommendation

39. The amendments to Section 15 to be proposed are unlikely to result in SMEs being required to change the accounting method applied to their interests in joint ventures. Consequently, most of the transition reliefs in IFRS 11 are not needed for SMEs.

40. The staff recommend the IASB require retrospective application of amended Section 15 applying paragraph 10.11(c) of the *IFRS for SMEs* Accounting Standard.

41. Further the staff recommend the IASB limit the transition disclosures for SMEs by requiring SMEs to disclose the quantitative impact for each financial statement line item affected for the annual period immediately preceding the date of initial application and not the current or earlier comparative periods, regardless of how many years of comparatives are presented (disclosure required by paragraph 10.13(b) of the *IFRS for SMEs* Accounting Standard).

Question 3 for the IASB
Does the IASB agree with the staff recommendation to propose transition requirements in the *IFRS for SMEs* Accounting Standard as set out in paragraphs 39–41 of this paper, for Section 15?

Section 19 *Business Combinations and Goodwill*

Amendments the IASB has tentatively decided to propose

42. The IASB has tentatively decided to propose amendments to Section 19 to:[3]

(a) align the definition of a business in the *IFRS for SMEs* Accounting Standard with the amended definition of a business issued in the amendments to IFRS 3 *Business Combinations* in October 2018; and

(b) align it with IFRS 3 for the acquisition method of accounting by: [4][5]

(i) adding guidance for a new entity formed in a business combination and the application guidance set out in paragraphs B13–B17 of IFRS 3;

(ii) recognising acquisition-related costs as an expense;

(iii) measuring contingent consideration at fair value; and

(iv) adding the requirements for an acquisition achieved in stages (step acquisitions).

Staff analysis

43. The IASB provided the following transition requirements for IFRS 3:

(a) the revised IFRS 3 (2008) should be applied prospectively. The IASB explained in paragraph BC432 of the Basis for Conclusions on IFRS 3 that applying it retrospectively would not be feasible. Consequently, specific transition requirements were added to IFRS 3 (2008) to addresses how to account for the contingent consideration balances arising from business

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

[4] IFRS 3 refers to the IFRS 3 (2008) version, including subsequent amendments to IFRS 3.

[5] If the IASB agree with the staff recommendations, set out as part of Agenda Paper 30D (Towards an Exposure Draft—Sweep Issues) of this meeting—that is, to propose further amendments to Section 19 to align with IFRS 3 for the acquisition method of accounting by referring to the definitions of assets and liabilities in the amended Section 2 *Concepts and Pervasive Principles* for identifiable assets acquired and liabilities assumed, and clarifying that an acquirer recognises contingent liabilities assumed only if there it is a present obligation and do not to permit the recognition of 'possible obligations', the staff recommendation as set out in paragraph 44 of this paper remains applicable for those further amendments proposed in Agenda Paper 30D of this meeting.

combinations with an acquisition date prior to the application of the revised IFRS 3, as issued in 2008;[6]

(b) when clarifying the definition of a business in IFRS 3 (2018 amendments), paragraph BC21B(f) of the Basis for Conclusions on IFRS 3 explains the IASB's views that retrospective application of the amendments to earlier acquisition transactions was not required because it is unlikely to provide useful information to users of financial statements, could have been costly to apply and could have been impracticable if hindsight were needed; and

(c) when updating paragraph 11 of IFRS 3 (May 2020 amendments), by replacing a reference to the *Framework* with a reference to the 2018 *Conceptual Framework*, the IASB explained in paragraph BC434H of the Basis for Conclusions on IFRS 3 as amended in May 2020 the IASB's views that an entity should apply the May 2020 amendments prospectively because no significant benefits would be gained from requiring either retrospective application or disclosure of early application.

Staff recommendation

44. For the amendments to Section 19 to be proposed, as set out in paragraph 42 of this paper, the staff recommend the IASB propose the same transition requirements as those developed for IFRS 3—so that:

(a) the amended Section 19 shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period in which the Exposure Draft of the Third Edition of the *IFRS for SMEs* Accounting Standard applies.

(b) assets and liabilities that arose from business combinations whose acquisition dates precede the application of the amended Section 19 should not be adjusted.

(c) contingent consideration balances arising from business combinations, whose acquisition dates preceded the date when an entity first applied the

[6] Paragraphs BC434A–BC434C of the Basis for Conclusions on IFRS 3.

amended Section 19, shall not be adjusted upon first application of the amended Section 19. Instead, an entity shall account for these balances using specific transition requirements as set out in paragraphs 65A–65D of IFRS 3.

Question 4 for the IASB
Does the IASB agree with the staff recommendation to propose transition requirements in the *IFRS for SMEs* Accounting Standard as set out in paragraph 44 of this paper, for Section 19?

Section 23 *Revenue*

Amendments the IASB has tentatively decided to propose

45. The IASB has tentatively decided:

(a) to develop amendments to the *IFRS for SMEs* Accounting Standard to reflect the principles and language used in IFRS 15 *Revenue from Contracts with Customers* by rewriting Section 23 *Revenue* of the *IFRS for SMEs* Accounting Standard with simplifications;[7] and

(b) to consider providing transition relief by permitting an entity to continue its current revenue recognition policy for any contracts already in progress at the date of initial application[8] or scheduled to be completed within a set time after the date of initial application.

[7] See Agenda Paper 30B *Towards an Exposure Draft—Simplifications to IFRS 15 Revenue from Contracts with Customers* of the February 2022 IASB meeting.

[8] Question S7 of the Request for Information and the October 2021 *IASB Update* refer to 'contracts already in progress at the transition date'. In this paper, the term 'transition date' is replaced with 'date of initial application' for consistency with the language when discussing transition requirements for other sections of the *IFRS for SMEs* Accounting Standard.

Question in the Request for Information

46. Question S7 of the Request for Information asked whether and how transitional relief should be available if amendments are made to align Section 23 of the *IFRS for SMEs* Accounting Standard with IFRS 15.

47. Respondents were asked if transition relief should be provided:

    (a) by permitting an entity to continue its current revenue recognition policy for any contracts in progress at the date of initial application or scheduled to be completed within a set time after the date of initial application;

    (b) by some other method; or

    (c) not at all.

Overall feedback

48. Although most respondents supported the transition method in paragraph 47(a) of this paper, feedback indicated that respondents interpreted this method differently. This was due to the method being drafted to include two possible approaches to applying the amendments to Section 23 prospectively:

    (a) permitting SMEs to continue their current revenue recognition policy for any contracts already in progress at the date of initial application; or

    (b) permitting SMEs to continue their current revenue recognition policy for any contracts that are already in progress at the date of initial application **and** are scheduled to be completed within a set time after the date of initial application (emphasis added).

49. Given the potential differences in respondents' interpretation of the approaches, it is not clear which approach was favoured by those respondents who supported the suggested transition method. However, the feedback indicated general support for allowing prospective application of the amendments to Section 23. Some respondents expressed concerns that the method could result in reporting revenue that does not faithfully represent the entity's financial performance and result in a lack of comparability between entities. Many of these respondents suggested that these concerns should be addressed through disclosures.

Staff analysis

Approaches to prospective application

50. The approach in paragraph 48(a) of this paper permits an entity to continue its current revenue recognition policy for any contracts in progress at the date of initial application, regardless of their expected date of completion. This could result in SMEs with long-term contracts continuing to apply their previous revenue recognition policy several years after initial application, which would reduce comparability for a longer period compared to the approach in paragraph 48(b) of this paper.

51. The approach in paragraph 48(b) of this paper permits an entity to continue its current revenue recognition policy only to contracts that are scheduled to be completed within a set time after the date of initial application, and is therefore more restrictive than the approach in paragraph 48(a) of this paper. The condition creates a sharp distinction between long-term contracts that are accounted for under an entity's previous revenue recognition policy and those accounted for by applying the requirements of the revised Section 23, based on remaining contract term. This would result in contracts in progress at the date of initial application being accounted for inconsistently. Accounting for these contracts consistently simplifies application of relief for preparers and makes it easier for users of financial statements to understand how the relief has been applied. The staff therefore recommend permitting SMEs to continue their current revenue recognition policy for any contracts already in progress at the date of initial application without introducing a condition based on the contract's expected date of completion.

Disclosure requirements for prospective application

52. Prospectively applying the revised Section 23 will result in SMEs accounting for contracts inconsistently in the initial year of application and future reporting periods. To help address this lack of comparability, respondents suggested SMEs provide additional disclosures (see respondents' feedback in paragraph 49 of this paper).

53. To help users understand and quantify the effect of applying the revised Section 23 prospectively, the staff recommend that SMEs are required to disclose the following information for reporting periods where they apply their previous revenue recognition policy:

    (a) the accounting policy for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services; and

    (b) the amount of revenue recognised during the period for contracts where the previous revenue recognition policy is still being applied.

54. The disclosure in paragraph 53(a) is consistent with the requirements of paragraph 8.5 of the *IFRS for SMEs* Accounting Standard, which requires disclosure of significant accounting policies.[9] The disclosure in paragraph 53(b) of this paper is consistent with the disclosure required by SMEs that prospectively applied the amendments made as part of the first comprehensive review of the Standard.[10]

55. Paragraph 10.13 of the *IFRS for SMEs* Accounting Standard requires an entity to quantify the impact of a change in accounting policy for the current and prior periods.

56. SMEs would not restate comparative information under the prospective approach recommended in paragraph 51 of this paper. Therefore, the staff recommend that SMEs are not required to quantify the impact of transition on prior periods when applying the revised Section 23 prospectively. However, to help users understand the impact of applying the revised Section 23 on trend information, the staff recommend that SMEs are required to quantify the impact of transition for the current period when applying the revised Section 23 prospectively.

57. The disclosure recommended in paragraph 56 of this paper requires SMEs to apply both their current and previous accounting policy for revenue in the year of initial

[9] In December 2021, the IASB tentatively decided to propose amendments to the Standard to align it with *Disclosure of Accounting Policies (Amendments to IAS 1)* issued in February 2021, which requires entities to disclose their material accounting policy information rather than their significant accounting policies.

[10] Paragraph A3 of the *IFRS for SMEs* Accounting Standard.

application. This could increase the overall implementation costs for SMEs on transition and conflict with the original objective of this transition method. To help minimise these costs, the staff recommend that SME are required to disclose only the adjustment to the profit or loss for the current period, rather than each financial statement line item affected (as required by paragraph 10.13(b) of the Standard). This would significantly reduce the volume of the disclosure and would be consistent with focus of the disclosures required when an entity transitions to the Standard.[11]

Other transition approaches

58. IFRS 15 requires an entity to apply one of the following transition approaches:

    (a) retrospective application to each prior reporting period presented (referred to as the 'full retrospective' method); or

    (b) retrospective application with the cumulative effective of initially applying IFRS 15 recognised in the current period (referred to as the 'cumulative catch-up' method).

59. IFRS 15 also includes practical expedients and options that an entity may elect to apply when using either of the methods described in paragraph 58 of this paper. Therefore, different variants of each method exist.

60. The recommendation in paragraph 51 of this paper would provide SMEs with an additional transition approach. Therefore, incorporating both the transition methods available in IFRS 15 into the *IFRS for SMEs* Accounting Standard would result in the Standard providing more accounting policy options than IFRS 15. This is inconsistent with the approach of simplifying new IFRS Accounting Standards by restricting the options available to SMEs compared to entities applying IFRS Accounting Standards.

61. Both the 'cumulative catch-up' method in IFRS 15 and the prospective method recommended in paragraph 51 of this paper offer simpler alternatives to retrospective application. If both methods were available to SMEs, the staff expect

[11] Paragraph 35.13(c) of the *IFRS for SMEs* Accounting Standard.

that most SMEs would choose the prospective method, as it provides more scope to ease the burden of transition compared to the ‘cumulative catch-up’ method. Therefore, the staff recommend that the ‘cumulative catch-up’ method is not available to SMEs applying the revised Section 23.

62. Unlike the ‘cumulative catch-up’ method and prospective method, the ‘full retrospective’ method provides users with comparable information across all periods presented and for all contracts. Therefore, including an option for SMEs to apply the revised Section 23 retrospectively gives scope for SMEs to provide comparable information based on their business needs and the needs of users. Providing practical expedients similar to those included in IFRS 15 allows SMEs to ease the burden of retrospective application. Therefore, the staff recommend providing SMEs with the option to applying the revised Section 23 retrospectively using the same practical expedients in IFRS 15.

Staff recommendation

63. The staff recommend the IASB propose the following transition requirements:

    (a) SMEs should be permitted to apply the revised Section 23 using either of the following methods:

        (i) retrospectively to each prior reporting period presented, using the same practical expedients in IFRS 15; or

        (ii) prospectively to contracts that begin after the date of initial application (ie permit SME to continue with their current revenue recognition policy for contracts in progress at the date of initial application).

    (b) SMEs that apply the revised Section 23 prospectively should make the following disclosures in periods where they continue to apply their previous revenue recognition policy:

        (i) the accounting policy for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services; and

(ii) the amount of revenue recognised during the period for contracts where the previous revenue recognition policy is still being applied.

(c) SMEs that apply the revised Section 23 prospectively should be exempt from the disclosure requirements in paragraph 10.13(b) of the *IFRS for SMEs* Standard, and should instead disclose the adjustment to the profit and loss for the effect of applying the revised Section 23 for the current period.

Question 5 for the IASB
Does the IASB agree with the staff recommendation to propose transition requirements in the *IFRS for SMEs* Accounting Standard as set out in paragraph 63 of this paper, for Section 23?

New Section *Fair Value Measurement*

Amendments the IASB has tentatively decided to propose

64. The IASB has tentatively decided:

(a) to align the definition of fair value in the *IFRS for SMEs* Accounting Standard with that in IFRS 13 *Fair Value Measurement*; and

(b) to align the guidance on fair value measurement in the *IFRS for SMEs* Accounting Standard with that in IFRS 13 by including the principles of the fair value hierarchy set out in IFRS 13.

Staff analysis

65. Application of IFRS 13 is required prospectively as of the beginning of the annual reporting period in which the IFRS is initially applied. Paragraph BC229 of the Basis for Conclusions on IFRS 13 explains the IASB's view that a change in the methods used to measure fair value is inseparable from a change in the fair value measurements (ie as new events occur or as new information is obtained, for example through better insight or improved judgement). Paragraph BC230 of the Basis for Conclusions on IFRS 13 explains that to provide fair value disclosures in the comparative previous periods would be difficult for some of the requirements

in IFRS 13 without the use of hindsight in selecting the inputs that would have been appropriate in prior periods.

Staff recommendation

66. The staff recommend the IASB propose prospective application of the new section *Fair Value Measurement* for SMEs. The SMEs shall not apply the disclosure requirements of this new section to the comparative previous periods.

Question 6 for the IASB
Does the IASB agree with the staff recommendation to propose transition requirements in the *IFRS for SMEs* Accounting Standard as set out in paragraph 66 of this paper, for the new section *Fair Value Measurement*?

Next steps

67. The staff will bring a further paper to the IASB on transition requirements for amendments to IFRS Accounting Standards and IFRIC Interpretations the IASB has tentatively decided to align the Standard with.

Appendix A—Summary of staff recommendations

A1. This appendix provides a summary of the staff recommendations for each section discussed in the paper.

Section 11 *Basic Financial Instruments (see paragraphs 21–22 of this paper)*

A2. The staff recommend the IASB propose the following for entities transitioning from IAS 39:

(a) require application of requirements in paragraph 35.9(a)–(b) of the *IFRS for SMEs* Accounting Standard for derecognition of financial assets and liabilities and hedge accounting;

(b) require SMEs to assess classification of financial assets based on facts and circumstances that exist on the date of initial application under the amended guidance of Section 11 and apply the resulting classification retrospectively; and

(c) SMEs that find it impracticable to apply the effective interest method retrospectively, to treat the fair value of the financial asset or financial liability at the date of initial application and at the end of each prior period presented as gross carrying amount (deemed) for financial assets and amortised cost (deemed) for financial liabilities.

A3. SMEs transitioning from Sections 11 and 12 to the amended Section 11 apply the amended Section 11 retrospectively, subject to the impracticable exemption for SMEs discussed paragraph 12 of this paper.

Section 9 *Consolidated and Separate Financial Statements (see paragraphs 33–35 of this paper)*

A4. The staff recommend the IASB propose the same transition requirements and relief that were provided for IFRS 10 as follows:

(a) SMEs would not be required to make adjustments at the date of initial application of the amended Section 9 for either:

(i) investees that would be consolidated both before and after the initial application of the amended Section 9; or

(ii) investees that would not be consolidated both before and after initial application of amended Section 9.

(b) if initial application of the amended Section 9 results in consolidating an investee not previously consolidated:

(i) SMEs shall measure the assets, liabilities and non-controlling interests (including goodwill, if the investee is a business) as if the investees had been consolidated from the date control was obtained;

(ii) if the application of the requirements in paragraph 33(b)(i) of this paper is impracticable, SMEs shall make adjustments from the earliest period doing such adjustments is practicable, which could also be the year of initial application.

(c) if initial application of the revised requirements results in no longer consolidating an investee previously consolidated:

(i) SMEs will apply the applicable requirements of *IFRS for SMEs* Accounting Standard retrospectively with the difference in carrying amounts adjusted in equity; and

(ii) if the application of the requirements in paragraph 33(c)(i) of this paper is impracticable, SMEs shall make such adjustments from the earliest period doing such adjustments is practicable, which could also be the year of initial application.

(d) an SME would be required to disclose quantitative impact for each financial statement line item affected for the annual period immediately preceding the date of initial application and not the current or earlier comparative periods (disclosure required by paragraph 10.13(b) of the *IFRS for SMEs* Accounting Standard).

A5. The staff recommend that the IASB add a transition requirement for when all the following conditions apply

(a) SMEs deconsolidate investees previously consolidated;

(b) SMEs start accounting for the investees as associates applying the cost model; and

(c) it is impracticable to determine the cost of the original purchase.

A6. The staff recommend that when these conditions apply, the IASB allow SMEs to measure the investment at deemed cost, being either:

(a) fair value at the date of initial application of the amended Section 9; or

(b) aggregate of the carrying amounts at the date of initial application of the amended Section 9 of the assets and liabilities, including goodwill, that SMEs had previously consolidated.

Section 15 *Investments in Joint Ventures (see paragraphs 39–41 of this paper)*

A7. The amendments to Section 15 to be proposed are unlikely to result in SMEs being required to change the accounting method applied to their interests in joint ventures. Consequently, most of the transition reliefs in IFRS 11 are not needed for SMEs.

A8. The staff recommend the IASB require retrospective application of amended Section 15 applying paragraph 10.11(c) of the *IFRS for SMEs* Accounting Standard.

A9. Further the staff recommend the IASB limit the transition disclosures for SMEs by requiring SMEs to disclose the quantitative impact for each financial statement line item affected for the annual period immediately preceding the date of initial application and not the current or earlier comparative periods, regardless of how many years of comparatives are presented (disclosure required by paragraph 10.13(b) of the *IFRS for SMEs* Accounting Standard).

Section 19 *Business Combinations and Goodwill* (see paragraph 44 of this paper)

A10. For the amendments to Section 19 to be proposed, as set out in paragraph 42 of this paper, the staff recommend the IASB propose the same transition requirements as those developed for IFRS 3—so that:

(a) the amended Section 19 shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period in which the Exposure Draft of the Third Edition of the *IFRS for SMEs* Accounting Standard applies.

(b) assets and liabilities that arose from business combinations whose acquisition dates precede the application of the amended Section 19 should not be adjusted.

(c) contingent consideration balances arising from business combinations, whose acquisition dates preceded the date when an entity first applied the amended Section 19, shall not be adjusted upon first application of the amended Section 19. Instead, an entity shall account for these balances using specific transition requirements as set out in paragraphs 65A–65D of IFRS 3.

Section 23 *Revenue* (see paragraph 63 of this paper)

A11. The staff recommend the IASB propose the following transition requirements:

(a) SMEs should be permitted to apply the revised Section 23 using either of the following methods:

(i) retrospectively to each prior reporting period presented, using the same practical expedients in IFRS 15; or

(ii) prospectively to contracts that begin after the date of initial application (ie permit SME to continue with their current revenue recognition policy for contracts in progress at the date of initial application).

(b) SMEs that apply the revised Section 23 prospectively should make the following disclosures in periods where they continue to apply their previous revenue recognition policy:

   (i) the accounting policy for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services; and

   (ii) the amount of revenue recognised during the period for contracts where the previous revenue recognition policy is still being applied.

(c) SMEs that apply the revised Section 23 prospectively should be exempt from the disclosure requirements in paragraph 10.13(b) of the *IFRS for SMEs* Standard, and should instead disclose the adjustment to the profit and loss for the effect of applying the revised Section 23 for the current period.

New Section *Fair Value Measurement* (see paragraph 66 of this paper)

A12. The staff recommend the IASB propose prospective application of the new section *Fair Value Measurement* for SMEs. The SMEs shall not apply the disclosure requirements of this new section to the comparative previous periods.