IFRS Accounting

Staff paper

Agenda reference: 30C

IASB® meeting

Date	**December 2023**
Project	**Second Comprehensive Review of the *IFRS for SMEs®* Accounting Standard**
Topic	**Requirement to offset equity instruments**
Contacts	Edlyn Chigerwe (edlyn.chigerwe@ifrs.org)

Purpose of the paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to:

   (a) consider the feedback on whether to remove paragraph 22.7(a) of the *IFRS for SMEs* Accounting Standard (the Standard). This is a topic that the IASB sought views on but for which amendments were not proposed in the Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft); and

   (b) decide whether to remove paragraph 22.7(a) of the Standard.

2. In this paper, the term SMEs refers to small and medium-sized entities that are eligible to apply the Standard.

Staff recommendation

3. The staff recommend the IASB remove paragraph 22.7(a) of the *IFRS for SMEs* Accounting Standard.

Structure of this paper

4. This paper is structured as follows:

   (a) background (paragraphs 5–11);

   (b) feedback from comment letters (paragraphs 12–14);

   (c) feedback from the SME Implementation Group (SMEIG) (paragraphs 15–18);

   (d) staff analysis (paragraphs 19–23); and

   (e) staff recommendation and question for the IASB (paragraph 24).

Background

Current requirements

5. Paragraphs 22.7–22.10 of the Standard set out requirements for how an entity recognises, measures and presents the issue of shares or other equity instruments.

6. Paragraph 22.7(a) of the Standard states:

> An entity shall recognise the issue of shares or other equity instruments as equity when it issues those instruments and another party is obliged to provide cash or other resources to the entity in exchange for the instruments:
>
> (a) if the equity instruments are issued before the entity receives the cash or other resources, the entity shall present the amount receivable as an offset to equity in its statement of financial position, not as an asset.

Feedback on the 2020 Request for Information

7. In January 2020, the IASB published the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* (2020 Request for Information) as a first step in its second comprehensive review.

8. The 2020 Request for Information asked respondents to identify any issues that they would like to bring to the IASB's attention relating to the Standard in addition to the topics addressed in the Request for Information.

9. A few respondents to the 2020 Request for Information suggested the IASB remove paragraph 22.7(a) of the Standard because:

 (a) there is no similar requirement in full IFRS Accounting Standards and thus paragraph 22.7(a) leads to divergence between the Standard and full IFRS Accounting Standards;

 (b) it may conflict with local legislation, which regard equity as having been issued and require the presentation of the related receivable as an asset; and

 (c) it is inconsistent with the European Accounting Directive. In this respondent's view further alignment of the Standard with the European Accounting Directive would foster the adoption of the Standard within the European Union.

10. As part of the first comprehensive review of the Standard, respondents raised similar concerns that suggested the IASB should remove paragraph 22.7(a) of the Standard as it may conflict with local legislation. At the time, the IASB decided to retain paragraph 22.7(a) of the Standard for the following reasons:[1]

 (a) current requirements are clear and simple to apply. It is preferable to require presentation as an offset to equity for practical reasons as it avoids the need to assess whether the receivable meets the definition of a financial asset; and

 (b) presentation in equity better presents the substance of the receivable on equity instruments.

[1] See Agenda Paper 8G of the April 2013 meeting and the IASB update.

Question in the Exposure Draft

11. Feedback from the first comprehensive review suggested that paragraph 22.7(a) of the Standard may conflict with local legislation. Similar feedback was received on the 2020 Request for Information, suggesting that the IASB remove paragraph 22.7(a) of the Standard because it diverges from full IFRS Accounting Standards, which include no similar requirement for equity instruments. Given this feedback, the IASB asked in the Invitation to Comment on the Exposure Draft, for views on removing paragraph 22.7(a) of the Standard.

Feedback from comment letters

12. The question in the Invitation to Comment is reproduced below:

Question 14
What are your views on removing paragraph 22.7(a)?

13. Most of the respondents who gave their views supported removing paragraph 22.7(a) of the Standard. Respondents made the following comments:

    (a) *application*—a few respondents said some jurisdictions do not allow equity instruments to be issued until the equity is fully paid. Some respondents also said the paragraph may conflict with local legislation and inclusion of a paragraph that conflicts with local legislation might inhibit adoption of the Standard. A few respondents provided examples of where there is a conflict with local legislation, which included legislation in Ghana and the European Accounting Directives.

    (b) *alignment*—some respondents said the paragraph should not diverge from full IFRS Accounting Standards and provided the following reasons:

        (1) the divergence from full IFRS Accounting Standards is not due to a simplification or due to a difference in the information needs of users of SMEs' financial statements; and

(2) removing the paragraph would allow jurisdictions to determine the most appropriate accounting treatment based on local legislation.

(c) *presentation*—a few respondents said presenting the amount receivable (financial asset) within equity does not faithfully represent the transaction because an entity should recognise a receivable if a contractual right to receive cash or another financial asset exists at the reporting date and a corresponding amount of equity if equity instruments are issued, and paragraph 22.7(a) of the Standard conflicts with this.

14. Some respondents who commented disagreed with removing paragraph 22.7(a) of the Standard and provided the following comments:

(a) paragraph 22.7(a) is consistent with local legislation. Jurisdictions mentioned by these respondents were South Africa and some countries in South America.

(b) if paragraph 22.7(a) is removed, SMEs will no longer have simplified requirements on how to present receivables on equity instruments. The paragraph should be retained if useful even to a small number of entities.

(c) removing paragraph 22.7(a) will result in the amount receivable being recognised as a financial asset, requiring the application of the proposed expected credit loss (ECL) model for SMEs, which would create complexities.

Feedback from the SME Implementation Group (SMEIG)

15. The SMEIG met on 13 July 2023 to discuss the feedback on the Exposure Draft. At that meeting the SMEIG was asked whether there might be any unintended consequences if paragraph 22.7(a) is removed from the Standard.

16. Some SMEIG members supported removing paragraph 22.7(a) of the Standard and said:

(a) *application*—jurisdictions have various legal requirements for receivables on equity instruments and removing the paragraph would enable consistency with these requirements; and

(b) *presentation*— presenting the amount receivable (financial asset) within equity does not faithfully represent the transaction. These SMEIG members provided similar reasons as those set out in paragraph 13(c) of this paper.

17. Some SMEIG members disagreed with removing paragraph 22.7(a) of the Standard and said:

(a) the paragraph is consistent with local legislation, for example in Colombia; and

(b) removing the paragraph will result in the amount receivable being recognised as a financial asset, requiring the application of the proposed ECL model for SMEs, which would create complexities.

18. One SMEIG member suggested adding a disclosure requirement that requires entities to disclose the amount of the receivable on equity instruments that has been presented as an offset to equity.

Staff analysis

19. The feedback on the Exposure Draft generally supports removing paragraph 22.7(a) of the Standard. In addition to this feedback, the staff think the following reasons support removing the paragraph:

(a) the paragraph may conflict with local legislation in some jurisdictions. It would not be possible for the IASB to amend the Standard to incorporate a requirement which is consistent with legislation across all jurisdictions.

(b) removing the paragraph would enable consistent application of the definition of an asset and equity in Section 2 *Concepts and Pervasive Principles* in determining the presentation of receivables on equity instruments.

(c) removing the paragraph would be consistent with proposed paragraph 2.127 in Section 2 of the Exposure Draft in which offsetting is generally not appropriate.

(d) removing the paragraph would be consistent with the IASB's alignment approach. This is because full IFRS Accounting Standards do not set out the presentation requirements for receivables on equity instruments. During the second comprehensive review the IASB consulted on the use of the alignment approach and decided it should continue with this approach. The alignment approach applies the principles of relevance to SMEs, simplicity and faithful representation, including the assessment of costs and benefits, in determining whether, and if so how, to update the Standard.

20. The staff acknowledge that paragraph 22.7(a) of the Standard is consistent with legislation in some jurisdictions (see paragraph 14(a) and paragraph 17(a) of this paper) and that removing this paragraph will result in SMEs no longer having a clear and simple requirement about how to present receivables on equity instruments (see paragraph 14(b) of this paper). If paragraph 22.7(a) of the Standard is removed, SMEs would need to make their own assessment of the presentation of receivables on equity instruments, and determine whether the receivable is a financial asset or a deduction from equity. If an SME determines that the receivable meets the definition of a financial asset the SME would be required to change its current accounting treatment.

21. One SMEIG member suggested requiring SMEs to disclose the amount of the receivable on equity instruments that has been presented as an offset to equity (see paragraph 18 of this paper). However, the staff note that users of SMEs' financial statements can obtain similar information from the disclosure in paragraph 4.12(a)(ii) of the Standard that requires SMEs to disclose the number of shares issued and fully paid and issued but not fully paid.

22. Removing paragraph 22.7(a) would result in a receivable on equity instruments being recognised as a financial asset when an entity concludes that the receivable meets the definition of an financial asset. Respondents noted that this would require application

of the proposed ECL model in Section 11 *Financial Instruments* of the Exposure Draft (see paragraph 14(c) and paragraph 17(b) of this paper), which could add further complexity for SMEs. However, the staff agrees with the feedback that removing paragraph 22.7(a) would allow SMEs to recognise and present the transaction based on the contractual terms and conditions (that is, an SMEs would recognise a receivable if a contractual right to receive cash or another financial asset exists at the reporting date), which will result in faithful representation. The staff also note that the IASB is reconsidering its proposals for the impairment of financial assets in the Exposure Draft, in particular whether and when to require an ECL model.[2]

23. In assessing the costs and benefits of removing paragraph 22.7(a) of the Standard, the staff note that the costs would include the additional cost for SMEs of assessing whether the receivable on equity instruments needs to be recognised as an asset or as an offset to equity. However, in the staff's view, the costs are outweighed by the benefits of removing paragraph 22.7(a), outlined in paragraph 19 of this paper.

Staff recommendation and question for the IASB

24. The staff recommend the IASB remove paragraph 22.7(a) of the *IFRS for SMEs* Accounting Standard.

Question for the IASB
Does the IASB agree with the staff recommendation in paragraph 24 of this paper to remove paragraph 22.7(a) of the *IFRS for SMEs* Accounting Standard?

[2] See Agenda Paper 30F Impairment of financial assets of the September 2023 meeting and the IASB update.