Staff paper

Agenda reference: 3

SME Implementation Group meeting

Date	**July 2023**
Project	**Second Comprehensive Review of the *IFRS for SMEs*® Accounting Standard**
Topic	**Feedback from comment letters on Exposure Draft—Topics for which amendments were not proposed**
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Purpose of this paper

1. In September 2022, the International Accounting Standards Board (IASB) published the Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (the Exposure Draft). The Exposure Draft was open for comment for 180 days, closing for comment on 7 March 2023. This paper summarises the feedback from comment letters on questions 12–14 of the Invitation to Comment (ITC) in the Exposure Draft, which ask about topics that the IASB considered but for which amendments to the *IFRS for SMEs* Accounting Standard were not proposed.

2. In this paper, the term SMEs refers to entities that are eligible to apply the *IFRS for SMEs* Accounting Standard.

Structure of the paper

3. The feedback in this paper is structured as follows:

   (a) overall feedback on topics that the IASB considered but for which amendments were not proposed (paragraphs 5–6);

   (b) responses about aligning Section 20 *Leases* with IFRS 16 *Leases*, Question 12 of the ITC (paragraphs 7–17);

   (c) responses about the recognition and measurement requirements for development costs, Question 13 of the ITC (paragraphs 18–24);

   (d) responses about the requirement to offset equity instruments, Question 14 of the ITC (paragraphs 25–28); and

4. The questions asked in the ITC are reproduced in grey boxes.

Overall feedback on topics considered but for which amendments were not proposed

5. The IASB received 70 comment letters. The Appendix to this paper lists the number of respondents that commented on questions 12–14 of the ITC.

6. Out of those respondents commenting on questions 12–14:

   (a) most agreed with the proposal to consider alignment with IFRS 16 in a future review of the Standard;

   (b) most supported the introduction of an accounting policy option to recognise intangible assets arising from development costs (that meet the specified criteria in IAS 38 *Intangible Assets*); and

   (c) most supported the removal of paragraph 22.7(a), which requires an entity to present the amount receivable from unpaid issued equity instrument as an offset to equity in the statement of financial position.

Section 20 *Leases* and IFRS 16 *Leases*

7. The IASB decided:

   (a) not to propose amendments to align Section 20 with IFRS 16; and

   (b) to consider amending Section 20 to align with IFRS 16 during a future review of the Standard.

8. The IASB asked for further information about the cost-benefit considerations, particularly on the areas listed in paragraphs (a) and (b) of Question 12 of the ITC.

Question 12 of the ITC
Do you agree with the IASB's decision to consider amending the Standard to align it with IFRS 16 in a future review of the Standard? In responding to this question, please comment on the cost–benefit considerations in paragraphs (a) and (b) [of Question 12].

9. Most respondents who commented on Question 12 agreed with the IASB's decision to consider amending Section 20 to align with IFRS 16 in a future review of the Standard.

10. Many respondents who agreed with the IASB's decision said waiting for the IASB to complete its post-implementation review of IFRS 16 will provide a better understanding of how to align and simplify the requirements of IFRS 16 for SMEs. Some respondents who agreed with the IASB's decision said this will allow SMEs to focus on the proposed amendments to the third edition of the Standard without imposing a disproportionate workload on SMEs.

11. Some respondents suggested the IASB should consider amending Section 20 to align with IFRS 16 during an interim review of the Standard, as soon as the post-implementation review of IFRS 16 is completed, rather than wait for the next comprehensive review of the Standard. A few of these respondents observed that waiting:

    (a) would delay the improvements from alignment with IFRS 16; and

(b) would result in inconsistencies with the proposed definition of liability and therefore the proposed revised Section 2 *Concepts and Pervasive Principles* (see paragraph BC243 of the Basis for Conclusions on the Exposure Draft).

12. Some respondents disagreed with the IASB's decision and said the IASB should consider aligning Section 20 with IFRS 16 in this review. Their reasons included:

(a) the benefits of aligning Section 20 with IFRS 16 (with appropriate simplifications) for both SMEs and users of their financial statements would outweigh the costs and waiting for a future review would delay the potential improvements introduced by IFRS 16; and

(b) there has been sufficient time and experience gained since implementation of IFRS 16 and the IASB should be aware of any significant implementation issues.

13. Some respondents said alignment with IFRS 16 should not be considered for SMEs (neither in the current review nor a future review) because the costs of implementing an aligned Section 20 would outweigh the benefits due to the complexity and the extent of judgement required to apply an aligned Section 20.

Cost-benefit considerations

14. Some respondents provided examples of costs that preparers of financial statements would incur implementing an aligned Section 20. These included costs of purchasing appropriate accounting software and updating systems, collating information and additional resources to make the required judgements. Some of these respondents said that the ongoing benefits of aligning with IFRS 16 would outweigh these one-off costs. A few respondents said the implementation experience of entities applying IFRS 16 would help reduce implementation costs for SMEs because it would identify implementation challenges and help the IASB to identify simplifications for SMEs.

15. Some respondents commented on the costs that users of financial statements could incur when information about leases is unavailable. Some respondents explained that

lenders and creditors would get better information from the recognition, in the statement of financial position, of the lessee's obligation to make lease payments. However, a few respondents said that the existing disclosure requirements in Section 20 provide users with sufficient information.

16. Some respondents who commented on Question 12 noted improvements to financial reporting that would arise from aligning Section 20 with IFRS 16. Improvements noted by a few respondents included:

    (a) users would be provided with information about SMEs' lease commitments that will result in greater transparency about SMEs' assets and liabilities. Furthermore, it would allow comparability between entities that borrow to buy assets and those that lease similar assets.

    (b) lenders would be provided with better information, which would assist SMEs seeking funding.

Possible simplifications

17. Some respondents commented on possible simplifications to the requirements in IFRS 16 to reduce the cost of implementation of an aligned Section 20 without reducing the usefulness of the reported information. Suggestions made by a few respondents included:

    (a) *Discount rate*—respondents suggested SMEs use a risk-free rate to discount lease payment to their present value.

    (b) *Reassessment of the lease liability*—respondents suggested reducing frequency of when the lease liability is remeasured and using the originally determined discount rate if the SME is unable to determine a revised discount rate.

    (c) *Lease term*—respondents suggested simplifying how SMEs determine the lease term compared to entities applying IFRS 16.

(d) *Low value asset exemption*—respondents suggested extending this exemption for SMEs, for example by specifying a percentage of total asset value or right of use asset value, or prescribing a monetary value, in the Standard.

(e) *Simplifications in local GAAP for SMEs*—respondents suggested the IASB consider simplifications made for private entities applying US GAAP or the UK Financial Reporting Council's proposed amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

Recognition and measurement requirements for development costs

18. The Standard requires all development costs to be recognised as expenses, whereas IAS 38 *Intangible Assets* requires the recognition of intangible assets arising from development costs that meet specified criteria. The requirement to recognise all development costs as expenses is a simplification to the requirements in IAS 38 and was made for cost-benefit reasons.

19. Feedback on the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* (Request for Information) questioned this cost-benefit decision. In response to this feedback the IASB asked for views on whether it should introduce an accounting policy option that permits an SME to recognise intangible assets arising from development costs that meet the criteria in paragraphs 57(a)–(f) of IAS 38, including views on the costs and benefits of doing so.

Question 13 of the ITC

What are your views on the costs and benefits, and the effects on users, of introducing an accounting policy option that permits an SME to recognise intangible assets arising from development costs that meet the criteria in paragraphs 57(a)–(f) of IAS 38?

20. Most respondents who commented on Question 13 supported introducing an accounting policy option that permits the recognition of intangible assets arising from development costs that meet the specified criteria in IAS 38. A few of these

respondents made the following comments on the costs, benefits and effects of this proposal:

(a) it would enable entities that incur significant development costs to demonstrate the extent to which the entity's operations may give rise to assets that generate future economic benefits, which will result in faithful representation and improve the quality of financial reporting. This will be particularly relevant for entities in the technology industry and in the start-up phase. Such entities are incurring more development costs than when the *IFRS for SMEs* Accounting Standard was first issued in 2009, for example because they are investing more in technology and innovation.

(b) it would encourage those SMEs to adopt the *IFRS for SMEs* Accounting Standard that are deterred from doing so because development costs are not recognised as intangible assets. Adopting this Standard could reduce the cost and effort of preparing financial statements for these entities.

(c) for many SMEs, the effort of tracking such costs and analysing them against subjective criteria may not justify the benefits. Providing an accounting policy option would enable SMEs that prefer to expense development costs based on cost-benefit considerations to continue to do so.

(d) such an accounting policy option has been introduced in other local GAAP such as Argentine GAAP, Swedish GAAP (K3), Canadian Accounting Standards for Private Entities and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and there are no known issues.[1].

21. A few respondents said if an accounting policy option is introduced, the criteria should be aligned with IAS 38 because the use of different words to convey the same principles would introduce additional complexity and uncertainty about the intended meaning. Furthermore, a few respondents suggested that field testing should be conducted for the criteria for capitalisation.

[1] Some of these local GAAP, such as Argentine GAAP and FRS 102 *The Financial Reporting Standard applicable in the* UK *and Republic of Ireland*, are based on the *IFRS for SMEs* Accounting Standard.

22. A few respondents suggested the current requirement in the Standard to recognise both research and development costs as an expense should remain unchanged. These respondents provided the following reasons:

    (a) lenders disregard information about capitalised development costs when making lending decisions.

    (b) SMEs lack the resources to demonstrate whether development costs meet the criteria in paragraphs 57(a)–(f) of IAS 38. Furthermore, the accounting policy option will introduce complexities due to subsequent judgment to be applied in determining useful life and impairment tests of the capitalised development costs.

    (c) retaining the current accounting treatment supports the principle of simplification and is consistent with the IASB's aim to restrict accounting policy options in the Standard (see paragraph BC257 of the Basis for Conclusions on the Exposure Draft).

23. A few respondents suggested the IASB await the results of its research pipeline project on intangible assets before making amendments to the *IFRS for SMEs* Accounting Standard.

24. A few respondents suggested the IASB should consider full alignment with IAS 38, which requires the capitalisation of development costs that meet specified criteria. These respondents provided the following reasons:

    (a) an entity choosing an accounting policy to recognise development costs as an expense when the criteria to capitalise is met would not result in faithful representation.

    (b) entities that incur significant development costs would have completed a research phase and be aware of the status of their development activities and be able to make the necessary judgements in determining whether these costs meet the specified criteria.

(c) many start-ups and entities in the technology sector are funded specifically to conduct research and development activities, and consequently, development costs might be the most significant asset in their statements of financial position.

(d) introducing an accounting policy option would reduce comparability between entities and increase complexity.

Requirement to offset equity instruments

25. Paragraph 22.7(a) of the Standard states that if equity instruments are issued before an entity receives cash or other resources, the amount receivable is presented as an offset to equity in the statement of financial position, instead of being presented as an asset.

26. Feedback on the Request for Information suggested that the IASB remove the requirement in paragraph 22.7(a) of the Standard because it diverges from full IFRS Accounting Standards and may conflict with local legislation. Therefore, the IASB asked for views on whether it should remove the paragraph.

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

27. Most of the respondents who commented on Question 14 supported the removal of paragraph 22.7(a) of the Standard. Respondents made the following comments:

(a) some respondents said the paragraph may conflict with local legislation and inclusion of a paragraph that conflicts with local legislation might inhibit adoption of the *IFRS for SMEs* Accounting Standard. A few respondents provided examples where there is a conflict with local legislation, which included Ghana and European Union member states.

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

(i) the divergence from full IFRS Accounting Standards is not due to a simplification nor due to differences in the information needs of users of SMEs' financial statements.

(ii) removing the paragraph allows each jurisdiction to decide the most appropriate accounting treatment based on local laws and legislation.

(c) a few respondents said application of this paragraph is not common and many jurisdictions do not allow the issue of equity instruments until fully paid.

(d) a few respondents said presenting the amount receivable (financial asset) within equity does not faithfully represent the transaction.

(e) a few respondents said 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) conflicts with this.

28. Some respondents who disagreed with the proposal to remove paragraph 22.7(a) provided the following comments:

(a) the paragraph is consistent with local legislation. Jurisdictions mentioned by respondents were South Africa and those in South America.

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

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

Appendix—Number of respondents commenting on Questions 12–14 of the Invitation to Comment

Table 1—Number of respondents commenting on Questions 12–14

Question	Number of Respondents
Q12—Section 20 *Leases* and IFRS 16 *Leases*	55/70 respondents
Q13—Recognition and measurement requirements for development costs	49/70 respondents
Q14—Requirement to offset equity instruments	52/70 respondents