Staff paper

Agenda reference: 30

IASB® meeting

Date	**November 2024**
Project	**Second Comprehensive Review of the *IFRS for SMEs®* Accounting Standard**
Topic	**Sweep issues relating to transition to the third edition of the *IFRS for SMEs* Accounting Standard**
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Purpose of this paper

1. At its July 2024 meeting, the International Accounting Standards Board (IASB) decided to start the balloting process for the *Third edition of the* IFRS for SMEs *Accounting Standard*.[1]

2. The staff has prepared a draft of the *Third edition of the* IFRS for SMEs *Accounting Standard*. The staff has received some suggestions on how the transition requirements in this draft could be simplified further.

3. The purpose of this paper is to ask the IASB whether to provide further relief for SMEs on transition to the third edition of the *IFRS for SMEs* Accounting Standard (the Standard).

[1] In addition, at its September 2024 meeting, the IASB decided to finalise the proposals in the Exposure Draft *Addendum to the Exposure Draft* Third edition of the *IFRS for SMEs* Accounting Standard with some minor revisions. IASB members confirmed they were satisfied that the IASB has complied with the applicable due process requirements.

4. In this paper, the term SMEs refers to entities that are eligible to apply the Standard. The term Exposure Draft refers to the Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard*.

Summary of staff recommendations

5. The staff recommend the IASB:

   (a) provide relief from the disclosure requirement in paragraph 10.13(b) of the Standard for the current period on transition to the third edition of the Standard; and

   (b) withdraw the proposed disclosure requirement in paragraph A28(b) of the Exposure Draft.

Structure of this paper

6. This paper is structured as follows:

   (a) background (paragraphs 7–13 of this paper);

   (b) issues to consider at this meeting (paragraph 14 of this paper);

   (c) feedback on the exposure draft (paragraphs 15–17 of this paper);

   (d) staff analysis (paragraphs 18–36 of this paper); and

   (e) staff recommendation and question for the IASB (paragraph 37 of this paper).

Background

Default approach to transition in Section 10 of the Standard

7. The requirements for applying changes in accounting policies are in Section 10 *Accounting Policies, Estimates and Errors* of the Standard. Paragraph 10.11 of the Standard requires an entity to account for:

   (a) 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 that amendment. In the third edition of the Standard, the transition requirements will be specified in Appendix A of the Standard.

   (b) all other changes in accounting policy retrospectively, subject to paragraph 10.12 of the Standard.

8. Paragraph 10.12 of the Standard states that when 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, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as 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.

9. Paragraph 10.13 of the Standard sets out specific disclosures requirements for changes in accounting policies from an amendment to the Standard.

Transition to the third edition of the Standard

10. Appendix A of the Exposure Draft sets out proposed transition requirements for SMEs transitioning to the third edition of the Standard. The proposed transition requirements provided some relief from applying new, amended or revised requirements in the third edition of the Standard retrospectively, as required by Section 10.

11. The IASB's approach in developing the transition relief in Appendix A was to reflect the comparable transition requirements in new or amended full IFRS Accounting Standards, when possible, with simplifications appropriate for SMEs.

12. In May 2024 the IASB considered the feedback on Appendix A in the Exposure Draft and tentatively decided to proceed with the proposed transition requirements.[2]

13. During drafting the third edition of the Standard, the staff received feedback that some requirements in Appendix A needed further clarification. In response to these comments, the staff has made some drafting changes to the proposals in the Exposure Draft to clarify application and improve the understandability of the requirements.

Issues to consider at this meeting

14. During drafting, two IASB members also suggested ways to further simplify the transition requirements for SMEs. They asked the following questions:

    (a) Disclosure of the effects on the current period—The IASB provided relief from disclosure of the effects on the current period on transition for some recent full IFRS Accounting Standards. Should the IASB provide relief from disclosure of the effects on the current period on transition to the third edition of the *IFRS for SMEs* Accounting Standard?

    (b) Restatement of comparatives—Currently the transition requirements require the restatement of some comparatives, but not others. Does the benefit to users of having some restatement of comparatives (but not others) justify the costs to SMEs?

[2] See May 2024 Agenda Paper 30E *Transition to the third edition of the* IFRS for SMEs *Accounting Standard*. The IASB tentatively decided to proceed with the transition requirements proposed in the Exposure Draft and add further relief from retrospective application for SMEs applying the amended paragraph 28.19 in Section 28 *Employee Benefits*.

Feedback on the Exposure Draft

15. Most respondents who commented on the Exposure Draft agreed with the transition requirements proposed in the Exposure Draft. Of those who agreed, many commented that the requirements would reduce the implementation costs for SMEs on transition.

16. Some respondents who commented on the Exposure Draft disagreed with the transition requirements proposed in the Exposure Draft. Most respondents who suggested alternative transition requirements suggested that SMEs be permitted to apply all the proposed amendments to the Standard prospectively. Some respondents also provided suggestions about how the IASB could provide additional relief from retrospective application. Suggestions included introducing:

    (a) an undue cost or effort exemption; or

    (b) an option to recognise the cumulative effect of initially applying the amended requirements at the date of initial application (similar to the 'cumulative catch-up' approach in IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*).

17. For example, Ernst & Young Global Limited stated:

> …Our view is that the transition requirements are unnecessarily complicated by requiring both prospective and retrospective application for different sections of the Standard. We would prefer the prospective approach to be applied for all sections of the Standard to maintain simplicity.
>
> If the Board goes ahead anyway, then where the retrospective approach to transition is considered necessary by the Board, we do not agree that a full retrospective approach is justified. We propose that a 'modified retrospective approach' similar to that which was allowed for preparers under full IFRS in transitioning to IFRS 9 *Financial Instruments* and IFRS *15 Revenue from Contracts with Customers*, be made available as an option to preparers of the Standard….

Staff analysis

Disclosure of effects on the current period

Disclosure of effects on current period—General

18. On transition to the third edition of the Standard, paragraph 10.13(b) would require an entity to disclose '… 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'. This paragraph is similar to paragraph 28(f) of IAS 8 *Basis of Preparation of Financial Statements.*

19. Some recent full IFRS Accounting Standards have provided relief from disclosing the information required by paragraph 28(f) of IAS 8:

    (a) paragraph C4 of IFRS 15 *Revenue from Contracts with Customers* allowed an entity to omit disclosing the information for the current period and for any additional comparative periods presented;

    (b) paragraph C3 of IFRS 17 *Insurance Contracts* exempted an entity from disclosing the information; and

    (c) paragraph 97Y of the Exposure Draft *Financial Instruments with Characteristics of Equity* proposes that an entity is not required to disclose the information.

20. Relief is also proposed in the Exposure Draft *Equity Method of Accounting* for the current period transition disclosures for cost-benefit reasons. Paragraph C10 of that Exposure Draft states:

    > An investor or joint venturer is not required to disclose the information required by paragraph 28(f) of IAS 8 (and an entity applying IFRS 19 *Subsidiaries without Public Accountability: Disclosures* is not required to disclose the information required by paragraph 178(f) of IFRS 19) for the current period or for any unadjusted additional prior period that the investor or joint venturer presents.

21. The Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* proposed relief from the disclosure requirement in paragraph 10.13(b) for the current period for the:

(a) amended requirements in:

(i) Section 9 *Consolidated and Separate Financial Statements*;

(ii) Section 15 *Joint Arrangements*;

(iii) Section 34 *Specialised Activities* for bearer plants; and

(b) the revised Section 23 *Revenue from Contracts with Customers* if SMEs choose to apply the section retrospectively.

The proposed relief reflects the equivalent transition requirements in full IFRS Accounting Standards.

22. Given that the IASB has considered such relief appropriate for recent full IFRS Accounting Standards for cost-benefit reasons, the staff recommend the IASB provide this relief for SMEs for all amendments in the third edition of the Standard, that is relief from the disclosure required by paragraph 10.13(b) for the current period. If such relief was provided, paragraph 10.13(b) would only apply to the immediately preceding period (and any additional prior periods that have been restated if an SME provides more than one year of comparatives).

23. The IASB has already decided that relief from paragraph 10.13(b) should be provided for the amendments most likely to result in significant changes to SMEs' financial statements on transition to the third edition of the Standard (see paragraph 21 of this paper). Extending this relief would provide helpful relief for SMEs affected by other amendments (for example, the amendments to Section 26 *Share-based Payment Transactions* and Section 28 *Employee Benefits*).

24. An SME would have the information required by paragraph 10.13(b) for the prior period from its restatement of comparative information for that period. However, to provide the information for the current period, the SME would need to parallel run

new and old accounting systems in the current period which could be burdensome and increase costs.

25. The staff think providing relief for the current period is supported by cost-benefit considerations. The relief is appropriate because SMEs will apply all of the amendments in the third edition of the Standard at same time (that is, at the effective date of 1 January 2027, which is 22 months after the expected date of issue). This is different to entities that applied the equivalent changes to full IFRS Accounting Standards (which are included in the third edition), where the effective dates of those changes spanned over ten years. Consequently, the cost and complexity of transition is likely to be higher for SMEs compared with such entities.

26. SMEs would still be required to restate comparatives unless prospective application is required or permitted by Appendix A of the Standard. Therefore, users would have comparable information for the prior period, except for the amendments that SMEs apply prospectively.

Disclosure of effects on current period—Revenue

27. The revised Section 23 is the most significant change where Appendix A permits prospective application. The Exposure Draft did not provide SMEs with relief from the disclosure required by paragraph 10.13(b) for the current period if SMEs choose to apply the revised Section 23 prospectively. Instead, paragraph A28(b) of the Exposure Draft proposed SMEs disclose the difference between:

(a) profit or loss for the current period applying the revised Section 23; and

(b) profit or loss for the current period applying its previous accounting policy for revenue from contracts with customers.

28. The disclosure requirement proposed in the Exposure Draft was based on paragraph 10.13(b). However, instead of requiring an SME to disclose the amount of the adjustment for each affected financial statement line item in the current period, the Exposure Draft proposed SMEs disclose only the adjustment to profit or loss. The proposed requirement was intended to reduce the volume of the disclosure compared

with what would be required applying paragraph 10.13(b), whilst still providing users with quantitative information about the effect of prospectively applying the revised Section 23.

29. Requiring SMEs to disclose the information described in paragraph 27 of this paper would be inconsistent with the staff recommendation to provide SMEs with relief from paragraph 10.13(b) for the current period. Therefore, the staff recommend the IASB withdraw the proposed disclosure requirement in paragraph A28(b) of the Exposure Draft.

30. The staff observe that withdrawing this requirement could make it difficult for users of SMEs' financial statements to understand the effect of applying the revised Section 23 for those SMEs that choose to do so prospectively. However, withdrawing the requirement would avoid SMEs having to run a parallel accounting system which would reduce the costs of initially applying the Section. In general, respondents' concerns about the cost of applying the revised revenue requirements proposed in the Exposure Draft focused on the costs of applying the requirements during the transition period, instead of the ongoing costs. The recommended relief would help to lower the costs during this period.

Restatement of comparatives

31. The default approach to transition in the Standard is retrospective application of new amended and revised requirements. Some relief from restatement of comparatives was proposed in the Exposure Draft. For example, the IASB proposed to:

(a) permit SMEs to apply the revised Section 23 prospectively to relieve some of the burden of applying a new revenue recognition model;

(b) require SMEs to apply the new Section 12 *Fair Value Measurement* prospectively; and

(c) permit or require prospective application of a few smaller amendments, including some requirements for share-based payments and foreign currency advance consideration.

Nevertheless, most of the other amendments in the third edition of the Standard would require retrospective application unless impracticable.

32. Some might argue that it does not add much value to users to have some restatement of comparatives, when restatement is not required for other changes in the third edition of the Standard.

33. Providing relief from restatement of comparatives would provide notable relief to SMEs, particularly as SMEs must apply all the amendments in the third edition at the same time (see paragraph 25 of this paper). A few respondents to the Exposure Draft suggested that the IASB consider a modified retrospective approach, rather than a full retrospective approach, on transition to the third edition of Standard. Under this approach SMEs would recognise the cumulative effect of initially applying the amended requirements at the date of initial application (see paragraphs 16–17 of this paper).

34. The staff acknowledge the points in paragraphs 32–33 of this paper. However, retrospective application in accordance with Section 10 of the Standard provides the most useful information for users of SMEs' financial statements. If an SME does not restate its comparatives, this would result in lack of comparability between an entity's reporting periods.

35. Furthermore, if the IASB provides relief from the disclosure in paragraph 10.13(b) of the Standard for the current period (as recommended by the staff in paragraph 22 of this paper), this would mean an SME's financial statements would not provide any information to enable a user to compare the effects of the old and new accounting policies on transition. Therefore, the staff do not think the IASB should consider a blanket exemption from restatement of comparative information (such as that described in paragraph 33) without further consultation.

36. On balance, given the stage of the project and that most respondents supported the proposed transition requirements in the Exposure Draft (see paragraph 15 of this paper), the staff think the IASB should only provide SMEs with relief from disclosing the effects of the adjustments on transition to the third edition of the Standard for the current period.

Staff recommendation

37. The staff recommend the IASB:

    (a) provide relief from the disclosure requirement in paragraph 10.13(b) of the Standard for the current period on transition to the third edition of the Standard; and

    (b) withdraw the proposed disclosure requirement in paragraph A28(b) of the Exposure Draft.

Question for the IASB
Does the IASB agree with the staff recommendation in paragraph 37 of this paper?