IFRS

STAFF PAPER

June 2019

IASB® Meeting

Project	**Comprehensive Review of the *IFRS for SMEs*® Standard**
Paper topic	New IFRS Standards—IFRS 9 *Financial Instruments*

CONTACT(S)	Yousouf Hansye	ykhansye@ifrs.org	+44 (0) 20 7246 6470
	Michelle Sansom	msansom@ifrs.org	+44 (0) 20 7246 6963

Purpose

1. At this meeting we are asking Board members if the Request for Information, that will be issued as part of the 2019 Comprehensive Review of the *IFRS for SMEs* Standard, should seek views on whether and, if so, how the requirements of the *IFRS for SMEs* Standard should be aligned with IFRS 9 *Financial Instruments*.

2. The objective of the Request for Information is to obtain evidence that will assist the Board in deciding whether and how to develop an Exposure Draft of amendments to the *IFRS for SMEs* Standard.

Summary of staff recommendations

3. The staff recommends that the Board seeks views in the Request for Information, on whether and, if so, how Section 11 *Basic Financial Instruments* and Section 12 *Other*

Financial Instrument Issues of the *IFRS for SMEs* Standard could be aligned with IFRS 9 *Financial Instruments*, namely:

(a) introducing principles for the classification and measurement of financial assets based on contractual cash flows;

(b) aligning the *IFRS for SMEs* Standard with IFRS 9 simplified approach for impairment of financial assets;

(c) changing the fall back to IAS 39 *Financial Instruments: Recognition and Measurement* to fall back to IFRS 9; if the requirements of the *IFRS for SMEs* Standard are aligned with IFRS 9.

4. The staff also recommends the Board clarifies in the Request for Information it does not intend to amend the requirements in the *IFRS for SMEs* Standard for:

(a) introducing the fair value through other comprehensive income option for equity investments;

(b) the initial recognition of financial instruments at the transaction price;

(c) financial liabilities and own credit risk;

(d) derecognition principles; and

(e) hedge accounting.

Structure of this paper

5. This paper is structured as follows:

(a) background (paragraphs 6–12):

(i) overview of IFRS 9 *Financial instruments* (paragraphs 6–9);

(ii) overview of Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instrument Issues* (paragraphs 10–12);

(b) applying the alignment principles—principle 1 relevance and principle 2 simplicity (paragraphs 13–76):

(i) classification and measurement of financial assets (paragraphs 16–43);

    (ii) financial liabilities and own credit (paragraphs 44–49);
    (iii) derecognition (paragraph 50);
    (iv) hedge accounting (paragraphs 51–58);
    (v) impairment (paragraphs 59–76);

(c) disclosures (paragraphs 77–78);

(d) principle 3—faithful representation (paragraphs 79–81);

(e) stakeholder views (paragraphs 82–86);

(f) other considerations (paragraphs 87–94):

    (i) the fall back to IAS 39 (paragraphs 87–91);

    (ii) IFRS 7 disclosures (paragraphs 92–94);

(g) Appendix A—Summary of SMEIG members' views on whether to align the *IFRS for SMEs* Standard with IFRS 9;

(h) Appendix B—Overview of Sections 11 and 12 and differences between Sections 11 and 12 and IAS 39 and IFRS 9.

(i) Appendix C—Simplifications to IAS 39 requirements in Sections 11 and 12 of the *IFRS for SMEs* Standard.

Background

Overview of IFRS 9 Financial Instruments

6. In July 2014 the Board issued IFRS 9 and completed its project to replace IAS 39. The objective of issuing IFRS 9 was to replace IAS 39 with a principle-based Standard. IFRS 9 became effective on 1 January 2018.

7. The package of improvements introduced by IFRS 9 included:
    (a) a logical model for classifying and measuring financial instruments;
    (b) new requirements for the accounting and presentation of changes in the fair value of an entity's own debt when the entity has chosen to measure that debt at fair value under the fair value option;

(c) a forward-looking expected credit loss model for measuring impairment; and

(d) a fundamental overhaul of all aspects of hedge accounting.

8. The overall scope, the recognition and derecognition requirements of IFRS 9 were carried forward broadly unchanged from IAS 39.[1]

9. IFRS 9 was issued after the 2012 Comprehensive Review of the *IFRS for SMEs* Standard was completed. The Board has not previously considered aligning the *IFRS for SMEs* Standard with IFRS 9.

Overview of Section 11 Basic Financial Instruments and Section 12 Other Financial Instrument Issues

10. Sections 11 and 12 of the *IFRS for SMEs* Standard were developed when IAS 39 and IFRS 7 *Financial Instruments: Disclosures* were effective; however, there are a number of significant differences between IAS 39 and IFRS 7, and the *IFRS for SMEs* Standard.

11. A list of these differences between Sections 11 and 12 and IAS 39 together with an overview of Sections 11 and 12 are provided in Appendix B of this agenda paper. A list of differences between Sections 11 and 12 and IFRS 9 is also provided in Appendix B of this agenda paper.

12. An entity applying the *IFRS for SMEs* Standard has a choice to apply either:

    (a) Sections 11 and 12; or

    (b) the recognition and measurement requirements of IAS 39 and the disclosure requirements of Sections 11 and 12.

[1] IFRS 9 paragraph IN11.

Applying the alignment principles—principle 1 relevance and principle 2 simplicity

13. At its May 2019 meeting (Agenda Paper 30A), the Board decided that to determine whether and how to align the *IFRS for SMEs* Standard with new and amended IFRS Standards, it would apply three principles:

    (a) relevance;

    (b) simplicity; and

    (c) faithful representation.

14. In considering if the Board should seek views on whether, and if so how, to align the *IFRS for SMEs* Standard with IFRS 9, the staff first assessed whether IFRS 9 meets the relevance criteria (that is, whether the problem addressed by IFRS 9 applies to entities applying the *IFRS for SMEs* Standard).

15. When applying the alignment principles, the staff assessed the IFRS 9 topics individually, as follows:

    (a) classification and measurement of financial assets (paragraphs 16–45);

    (b) financial liabilities and own credit (paragraphs 44–49);

    (c) hedge accounting (paragraphs 51–58); and

    (d) impairment (paragraphs 59–76).

Classification and measurement of financial assets

Principle 1—Relevance

Classification of financial assets—IFRS 9

16. IFRS 9 applies a principle-based approach to the classification of financial assets – that is it applies one classification approach for all types of financial assets. Applying IFRS 9, when an entity initially recognises a financial asset its classification is based on:

    (a) the contractual cash flow characteristics; and

    (b) the business model for managing the financial asset.

17. Only financial assets whose contractual cash flows are solely payments of principal and interest (SPPI) are eligible to be measured at amortised cost or fair value through other comprehensive income (FVOCI); measurement is dependent on the business model in which the asset is held.

Classification of financial assets—IFRS for SMEs Standard

18. Section 11 of the *IFRS for SMEs* Standard provides a list of examples of basic financial instruments[2] as well as a list of conditions a debt instrument needs to satisfy to qualify as a basic financial instrument and, thereby, for section 11[3] to apply. Section 11 also provides examples of debt financial instruments that *do not* satisfy the conditions and therefore do not qualify as basic financial instruments.[4]

19. Financial instruments within the scope of Section 11 after initial recognition, are measured at amortised cost (or in some cases the cost model), except for investments in non-convertible and non-puttable preference shares and non-puttable ordinary shares that are publicly traded or whose fair value can otherwise be measured reliably without undue cost or effort.

20. Financial instruments that do not qualify as basic financial instruments are within the scope of Section 12 and are measured at fair value through profit or loss.

Staff analysis

21. In relation to the classification of financial assets, the *IFRS for SMEs* Standard (Sections 11 and 12) and IFRS 9 were developed based on consistent thinking. However, while the *IFRS for SMEs* Standard uses examples to determine the classification of financial assets, IFRS 9 uses principles.

22. The staff believes that the current approach to the classification of financial assets in the *IFRS for SMEs* Standard is closer to IFRS 9 than to IAS 39. For example, the

---

[2] *IFRS for SMEs* Standard, paragraph 11.8.

[3] *IFRS for SMEs* Standard, paragraph 11.9.

[4] *IFRS for SMEs* Standard, paragraph 11.11.

available-for-sale and held-to-maturity classifications in IAS 39 are not available in the *IFRS for SMEs* Standard. However, entities applying the *IFRS for SMEs* Standard currently do not have to assess the business model for managing the financial asset and the asset's contractual cash flow characteristics to determine the classification of financial assets. Entities applying the *IFRS for SMEs* Standard classify financial assets as basic or complex using the examples and conditions in Section 11.

23. The staff believes the Board should seek views on aligning the *IFRS for SMEs* Standard current examples and conditions for classifying financial assets with a principle-based solution based on IFRS 9 principles.

24. A principle-based requirement based on IFRS 9 principles will bring several benefits to users and preparers of financial statements applying the *IFRS for SMEs* Standard, including:

    (a) providing a clearer rationale for measuring financial assets at either amortised cost or fair value; helping users understand the financial reporting of financial assets. The existing examples in Section 11 that determine how a financial asset can or must be classified can be used to supplement the principles.

    (b) providing a sound basis for classifying financial assets at amortised cost by applying the solely payment of principal and interest (SPPI) test. Consequently, classification determined based on the SPPI test faithfully represents the instrument's characteristics and provides relevant information on an entity's performance.

25. The staff notes that the UK Financial Reporting Council (FRC) has amended the conditions debt instruments have to satisfy in order to be within the scope of Section 11 *Basic Financial Instruments* of FRS 102 (which is based on the *IFRS for SMEs* Standard). The amendments were made in response to concerns about the possibility of unintended accounting consequences in relation to basic debt instruments when FRS 102 was issued in the UK.

26. The FRC received feedback that the conditions debt instruments must satisfy in order to be measured at amortised cost were too restrictive. Consequently, some financial

instruments would need to be measured at fair value, although amortised cost is a relevant measurement basis as it captures the risks associated with those instruments adequately.

27. As part of its consultation on amending FRS 102 the UK FRC noted that IAS 39 permits the measurements of these instruments at amortised cost.[5] We analysed the impact of applying IFRS 9's principle-based approach in respect of the classification of financial assets to these instruments and concluded that the result would be the same, that is, amortised cost would be applied.

28. We believe the findings of the UK FRC supports our recommendation to bring a principle-based approach to the *IFRS for SMEs* Standard.

29. A more principle-based approach would be of benefit to entities applying the *IFRS for SMEs* Standard. Given that entities applying the *IFRS for SMEs* Standard mostly hold simple financial instruments, assessing the contractual cash flow characteristics will often be unambiguous.

30. The staff therefore takes the view that using the contractual cash flow test will result in relevant information and assist application for entities applying the *IFRS for SMEs* Standard. The staff recommends that the Board seeks views, as part of the Request for Information on:

    (a) introducing the SPPI test for financial assets; and

    (b) the likely costs and benefits of the SPPI test.

Principle 2—Simplicity

31. The staff proposes that in aligning the *IFRS for SMEs* Standard with IFRS 9, the classification and measurement of financial assets should be simplified by:

---

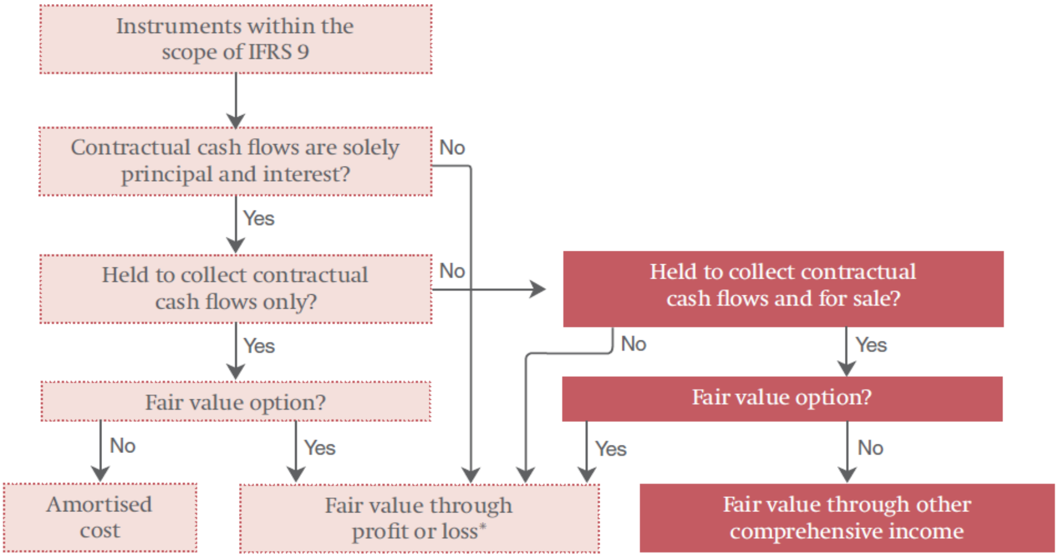
[5] FRC, *FRED 54 Draft Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland Basic financial instruments*, February 2014.

(a) removing the requirement to determine how financial assets should be classified and measured on the basis of the entity's business model for managing the financial asset; and

(b) removing the option to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument.

Contractual cash flow characteristics and business model for managing financial assets

32. The flowchart below outlines the process applying IFRS 9 for classifying financial assets to determine how they should be measured:



* Presentation option for equity investments to present fair value changes in OCI

33. Applying IFRS 9, two criteria are used to determine how financial assets should be classified and measured:

(a) the entity's business model for managing the financial assets; and

(b) the contractual cash flow characteristics of the financial asset.

34. From the flowchart above, the business model assessment only applies to financial assets with cash flows that are solely payments of principal and interest to determine if they are subsequently measured at amortised cost or fair value through profit or loss. Financial assets whose contractual cash flows are *not* solely payments of

principal and interest are measured at fair value by default and the business model does not affect their classification.

35. The staff does not think the business model test is needed in the *IFRS for SMEs* Standard because entities applying the *IFRS for SMEs* Standard are unlikely to hold financial assets based on business model. As noted by one SMEIG member also raised the issue that few entities applying the *IFRS for SMEs* Standard have detailed business plans for their financial assets Removing the requirement to assess the entity's business model for managing the financial assets to determine how financial assets should be classified and measured will be a significant relief for entities applying the *IFRS for SMEs* Standard and make the classification model simpler and easier to apply.

36. The *IFRS for SMEs* Standard does not currently include the category of fair value through other comprehensive income for debt instruments. The staff does not recommend requiring or permitting this category as it would result in complexity for entities applying the *IFRS for SMEs* Standard.

37. Removing the business model test also eliminates the requirement to reclassify financial assets between measurement categories.

Investments in equity instruments

38. IFRS 9 requires equity instruments to be measured at fair value with changes in fair value recognised in profit or loss (FVPL). However, at initial recognition an entity can make an irrevocable election to present in other comprehensive income, subsequent changes in the fair value of an investment in an equity instrument that is neither held for trading nor contingent consideration in a business combination (the FVOCI election). This option is not currently available in the *IFRS for SMEs* Standard and the staff does not support introducing it. Applying the *IFRS for SMEs* Standard, equity instruments are measured at fair value through profit or loss and the staff believes this requirement should remain unchanged.

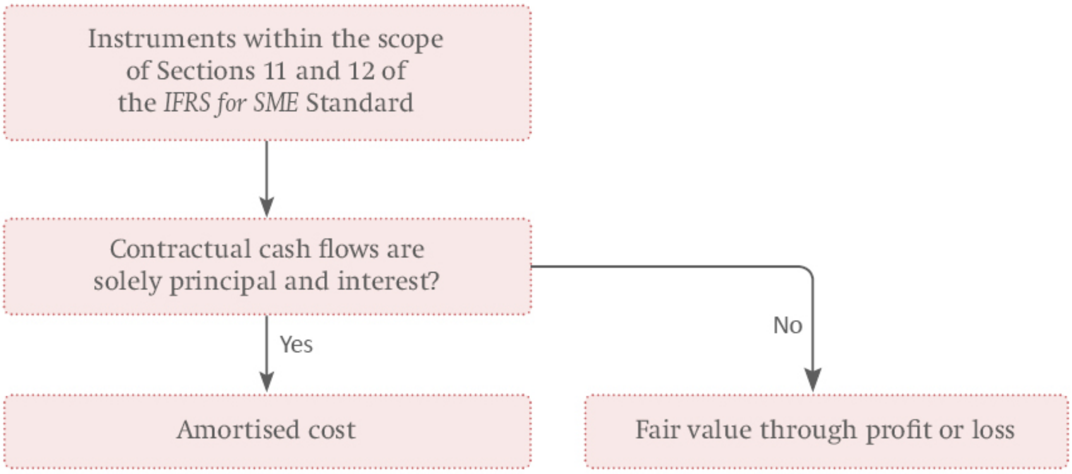
39. Furthermore, limiting the classification categories reduces complexity for entities applying the *IFRS for SMEs* Standard. The staff does not think there is an appetite

from entities applying the Standard for this additional classification category for equity instruments.

40. Consequently, the staff does not recommend that the Board seeks views on aligning the *IFRS for SMEs* Standard with the IFRS 9 requirements for FVOCI option for investments in equity instruments and that the Board is clear in the Request for Information that this does not intend to amend the Standard for this topic.

Proposed approach for classification of financial assets—IFRS for SMEs Standard

41. The flowchart below outlines the process for classifying financial assets to determine how they should be measured if the simplifications are included in the *IFRS for SMEs* Standard.



42. The requirement for initial recognition in Section 11 is measurement at the transaction price unless the arrangement constitutes a financing transaction, in which case the cash flows from the instrument are discounted.[6] The staff believes this requirement should be retained, and does not recommend aligning Section 11 with the IFRS 9 requirement to measure financial instruments initially at fair value. This is because in practice, the differing terminology is unlikely to result in any significant

[6] *IFRS for SMEs* Standard, paragraph 11.13.

difference in value on initial recognition for entities applying the *IFRS for SMEs* Standard.

43. Introducing a principle-based approach should assist preparers applying the *IFRS for SMEs* Standard. Staff recommends that those principles are supplemented with examples, including retaining (an updating if necessary) the current examples in Section 11.

Financial liabilities and own credit

Principle 1—Relevance

44. IFRS 9 carried forward IAS 39's treatment of financial liabilities essentially unchanged.
45. The issue IFRS 9 addressed in relation to financial liabilities was the volatility in profit or loss caused by changes in an entity's own credit risk of financial liabilities an entity elected to measure at fair value under the fair value option. The Board addressed the criticism that the requirements of IAS 39 were counterintuitive—that is, when an entity's credit quality declines the value of its own financial liabilities correspondingly falls and if those financial liabilities are measured at fair value a gain is recognised in profit or loss (and vice versa).

46. To address the so-called 'own credit risk' issue, IFRS 9 requires changes in the fair value of an entity's own credit risk to be recognised in other comprehensive income rather than in profit or loss.

47. When the *IFRS for SMEs* Standard was developed, the Board's approach to financial instruments was to enhance comparability and reduce complexity by limiting the classification categories, specifying a measurement attribute and limiting the use of other measurement attributes.[7] Consequently, the fair value option was eliminated.[8]

---

[7] *IFRS for SMEs* Standard, Basis for Conclusions paragraph BC100.

[8] *IFRS for SMEs* Standard, Basis for Conclusions paragraph BC106.

48. The staff agrees with the Board's previous decision that the issue of own credit risk is not applicable to entities applying the *IFRS for SMEs* Standard.

49. Consequently, the staff does not recommend that the Board seeks views on aligning the *IFRS for SMEs* Standard with the IFRS 9 requirements for own credit risk and that the Board is clear in the Request for Information that it does not intend to amend the *IFRS for SMEs* Standard for this topic.

Derecognition

50. The staff supports retaining the existing requirements for derecognition of a financial asset and a financial liability in Section 11. This is because the requirements for derecognition of financial assets and financial liabilities were carried forward unchanged from IAS 39 to IFRS 9[9] and the principle for derecognition is already simplified in the *IFRS for SMEs* Standard.

Hedge accounting

Principle 1—Relevance

51. The Project Summary for IFRS 9 states:

> The hedge accounting requirements in IAS 39 were developed when hedging activities were relatively new and not as widely understood as they are today. As a result of the increased use and sophistication of hedging activities the IASB decided to undertake a fundamental overhaul of all aspects of hedge accounting.

52. IFRS 9 includes new hedge accounting requirements that represent a major overhaul of hedge accounting and introduce significant improvements, principally by aligning the accounting more closely with risk management.

[9] IFRS 9 paragraph BC3.31.

53. IFRS 9 allows an entity to choose as its accounting policy to continue to apply the hedge accounting requirements of IAS 39 or the requirements in IFRS 9[10] pending finalisation of the Board's Dynamic Risk Management project.

54. In practice, a significant number of IFRS preparers—financial institutions in particular—have elected to continue to apply hedge accounting according to IAS 39 rather than IFRS 9.[11]

55. The staff takes the view that the current hedging requirements set out in Section 12 are not 'broken'. Section 12 focuses on the types of hedging that SMEs are likely to use and only allows hedge accounting for particular risks. The hedging requirement is well understood and accepted by users and preparers of financial statements based on the *IFRS for SMEs* Standard.

56. Consequently, the staff are not recommending any change to the hedging requirements of the *IFRS for SMEs* Standard.

57. In January 2019, the staff requested SMEIG members' views on aligning the *IFRS for SMEs* Standard with IFRS 9. As part of the feedback, a member questioned the need for any guidance in the *IFRS for SMEs* Standard because, in his view, very few entities apply the hedge accounting requirements in Section 12. Entities can fall back to IAS 39[12].

58. The staff recommends that the Request for Information seeks views;

    (a) on the need for requirements on hedge accounting for entities applying the *IFRS for SMEs* Standard; and

    (b) subject to paragraph 58(a), retain the current requirements for hedge accounting in Section 12.

---

[10] IFRS 9 paragraph 7.2.21.

[11] Snapshot: Exposure Draft *Interest Rate Benchmark Reform*, May 2019.

[12] This applies even if the fall back to IAS 39 is changed to a fall back to IFRS 9 because IFRS 9 allows companies, when they first apply IFRS 9, to choose as an accounting policy to continue to apply the hedge accounting requirements of IAS 39.

Impairment

Principle 1—Relevance

59. The impairment model in IFRS 9 reflects a fundamentally different approach to the model in IAS 39.

60. The impairment model in IAS 39 (an incurred loss model) may delay the recognition of credit losses because an impairment test is not required until there is evidence of a trigger event. The current requirements for impairment of financial assets measured at cost or amortised cost in the *IFRS for SMEs* Standard are based on IAS 39.[13]

61. During the financial crisis, the delayed recognition of credit losses on loans (and other financial instruments) was identified as a weakness of the incurred loss model in IAS 39—impairment losses on financial assets were considered to be recognised too late. The impairment requirement in IFRS 9 addressed this problem by requiring an entity to recognise expected credit losses and to update the amount of expected credit losses recognised at each reporting date to reflect deterioration in the credit risk of financial instruments.

62. The IFRS 9 impairment model brings a number of benefits. The Project Summary for IFRS 9 states:

> The main objective of the new impairment requirements is to provide users of financial statements with more useful information about an entity's expected credit losses on financial instruments. ….
>
> This model is forward-looking and it eliminates the threshold for the recognition of expected credit losses, so that it is no longer necessary for a trigger event to have occurred before credit losses are recognised. Consequently, more timely information is required to be provided about expected credit losses.

[13] *IFRS for SMEs* Standard, paragraphs 11.21–11.26.

63. The staff acknowledges that the IFRS 9 impairment model provides better quality and more relevant information for users of financial statements than the incurred loss model.

64. The scope of the *IFRS for SMEs* Standard excludes entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this criterion).[14] Consequently, the staff does not believe the IFRS 9's general approach for impairment is relevant for entities applying the *IFRS for SMEs* Standard.

65. That said, the staff supports replacing the existing impairment requirements in the *IFRS for SMEs* Standard with new requirements based on the IFRS 9 simplified approach for trade receivables, contract assets and lease receivables (simplified approach) because the expected loss model is widely regarded as an improvement on IAS 39.

66. The simplified approach will achieve a similar outcome as IFRS 9's general approach and provide more useful and relevant information than the incurred loss model. The simplified approach achieves an appropriate balance between the benefits of an expected loss model and operational costs and complexity.

67. In light of the above analysis of the benefits of the IFRS 9 impairment model, on balance, the staff believes the benefits of moving to the simplified approach outweigh the costs and that the model will bring relevant information to users.

68. The staff acknowledges that the introduction of an expected credit losses requirement, even with the proposed simplification, would require implementation cost and effort which could be significant. The Request for Information and outreach activities will help the Board understand the extent of the costs and

[14] *IFRS for SMEs* Standard, paragraph 1.3(b).

challenges so that it can take those into consideration when determining the next steps. The staff proposes that the Request for Information seeks views on:

(a) whether IFRS 9 simplified approach is 'fit for purpose' for the population of entities applying the *IFRS for SMEs* Standard;

(b) whether recognition of expected losses rather than incurred losses would provide more relevant information for users of financial statements applying the *IFRS for SMEs* Standard; and

(c) the likely costs and benefits of the simplified approach for entities applying the *IFRS for SMEs* Standard.

Principle 2—Simplicity

Recognition of expected credit losses

69. The general approach to impairment in IFRS 9 requires a loss allowance for lifetime expected credit losses to be recognised for a financial instrument if there has been a significant increase in credit risk (measured using the lifetime probability of default) since initial recognition of the financial asset. If, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, a loss allowance for 12-month expected credit losses is recognised.

70. The staff has considered alternative approaches for incorporating an expected credit loss model in the *IFRS for SMEs* Standard (for example, including the IFRS 9 impairment model, drafting a simplified version of the expected loss model) but favours requiring the simplified approach ('lifetime credit loss' model) for all financial assets. This is because the simplified approach is less time consuming and challenging than other approaches. Furthermore, implementing the simplified approach is less costly than implementing the other approaches, and is also less complex.

71. IFRS 9 simplified approach requires the loss allowance to be measured at an amount equal to lifetime expected credit losses.[15] Entities applying the *IFRS for SMEs* Standard are unlikely to have sophisticated credit risk management systems. The simplified approach reduces the need to track increases in credit risk separately. Therefore, the simplified approach alleviates the practical concerns for these entities in tracking changes in credit risk to determine whether there has been a significant increase in credit risk.

72. On balance, the staff thinks the simplified approach captures the underlying economics of a transaction while easing operational complexities.

Measurement of expected credit losses

73. IFRS 9 requires an entity to measure expected credit losses (applying either the general approach or the simplified approach) of a financial instrument in a way that reflects:[16]
    - (a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
    - (b) the time value of money; and
    - (c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

74. The staff proposes to simplify the measurement requirement by removing the requirement to evaluate a range of possible outcomes and require that expected credit losses reflect the most likely outcome. This eliminates the need for detailed simulations of scenarios.

Staff recommendation on simplifications

75. In order to balance the costs and benefits of introducing the simplified approach, staff recommends simplification of the measurement of expected credit losses.

---

[15] IFRS 9 paragraph 5.5.15.

[16] IFRS 9 paragraph 5.5.17.

76. The staff also recommends that the Board consult on the suitability of the proposed simplifications as part of the Request for Information.

Disclosures

77. Should the Board decide to align the *IFRS for SMEs* Standard with IFRS 9 principles, the staff would analyse the new disclosure requirements of IFRS 7 to assess which disclosures are needed in the *IFRS for SMEs* Standard.

78. Given the above simplifications to classification of financial instruments and measurement of the simplified impairment approach, the staff believes few of the new disclosure requirements in IFRS 7 will be applicable to entities applying the *IFRS for SMEs* Standard.

Principle 3—Faithful representation

79. The staff believes, applying principle 1, that the *IFRS for SMEs* Standard could benefit from incorporating improvements introduced in IFRS 9 that relate to classification of financial assets and impairment of financial assets.

80. In applying principle 2, the staff proposed simplifications to be included in the classification model and the simplified impairment approach. In this section, the staff analyses whether financial statements prepared applying the proposed simplifications will provide information that faithfully represents transactions and is useful to users of financial statements.

81. The staff is of the view that the proposed simplifications achieve an acceptable cost-benefit trade-off, whilst allowing users to receive relevant, but different information from applying IFRS 9.

Proposed additional simplifications	Impact on faithful representation
(a) Removing the business model test (paragraphs 31–43)	The staff believes the right trade-off is achieved between relevance and simplicity through removing the business model. Faithful representation is still achieved because removing the business model assessment is unlikely to significantly impact the classification for financial assets held by entities applying the *IFRS for SMEs* Standard.
(b) Impairment: removing the general approach and requiring only the simplified approach and simplify the measurement of expected credit losses (paragraphs 69–76)	The staff acknowledges the difference in expected credit losses under the general and simplified approaches due to the absence of a distinction between 12-month and lifetime expected credit losses under the simplified approach. Entities applying the *IFRS for SMEs* Standard do not need the general approach as they are unlikely to hold financial instruments for which this approach was developed. The simplified approach also facilitates a better prediction of cash flow given that expected losses are recognised earlier and reflect full lifetime losses. Therefore, the staff has concluded that the simplified approach is the relevant approach for entities applying the *IFRS for SMEs* Standard and that it provides faithful representation. Furthermore, introducing the IFRS 9 simplified approach will enable users to better predict future cash flows than the current incurred loss model in Section 11.

Stakeholder views

82. In February 2019 the staff asked members of the Small and Medium-sized Entities Implementation Group (SMEIG) for their views on whether to align the *IFRS for SMEs* Standard with IFRS 9.
83. A summary of their responses is set out in Appendix A. SMEIG members were not asked whether they support or object to aligning the *IFRS for SMEs* Standard with IFRS 9.
84. The main objection raised by SMEIG members against alignment relates to the complexity of IFRS 9 and the need to observe implementation experience of IFRS 9 before introducing the requirements for entities applying the *IFRS for SMEs* Standard.
85. Other stakeholders' views on whether to align the *IFRS for SMEs* Standard with IFRS 9 are mixed. An Asian-Oceanian Standard-Setters Group (AOSSG) survey on the *IFRS for SMEs* Standard found that:

The *IFRS for SMEs* Standard should incorporate the main requirements of IFRS 9 as IFRS 9 is widely regarded as an improvement from IAS 39.	Cambodia, India, Nepal and Pakistan
The *IFRS for SMEs* Standard should *not* incorporate the main requirements of IFRS 9 because: • China and Korea: main requirements of IFRS 9 are too complex for small enterprises. • Malaysia: current recognition and measurement requirements in the *IFRS for SMEs* Standard provide adequate guidance for recognising and measuring financial instruments. The business model, cash flow characteristics test and forward-looking expected loss model for impairment may add compliance costs for SMEs without providing obvious benefits. The incurred loss model for impairment is more appropriate for SMEs. • Sri Lanka: SMEs do not have complex instruments and frequent changes in accounting standards will be burdensome. • The Philippines: expected credit losses could create complexities for SMEs. • Syria: SMEs do not have the necessary expertise, data and systems to implement the expected credit losses model for impairment of financial assets. • Thailand: it is difficult for SMEs, which are already burdened, to judge business models when classifying financial instruments.	China, Korea, Malaysia, Sri Lanka, Syria, Thailand and the Philippines
The fallback to IAS 39 should be removed.	Cambodia, Nepal and Pakistan
Change the fallback to IAS 39 to fall back to IFRS 9.	India, Malaysia, Sri Lanka, Syria, Thailand and The Philippines

86. The UK FRC proposed incorporating IFRS 9 into *FRS 102—The Financial Reporting Standard applicable in the UK and Republic of* Ireland as part of its triennial review of FRS 102.[17] A significant minority supported the FRC's preferred option to require financial institutions (or sub-sets thereof, for example, banks and building societies) to apply the impairment requirements of IFRS 9, whilst replacing the existing impairment requirements of FRS 102 for all other entities with new requirements based on the simplified approach in IFRS 9. The UK FRC favoured this option because all financial institutions (or sub-sets thereof) would calculate impairment losses for financial assets on the same basis, which would address the deficiencies identified in the aftermath of the financial crisis. Respondents who opposed this approach expressed the following conflicting views:

   (a) imposing simplified IFRS 9 requirements adds unnecessary complexity and may have unintended consequences, specifically in relation to intercompany receivables; and

   (b) the FRC should explain why the requirements of IFRS 9 are expected to have a significant and disproportionate impact on non-financial institutions, thus necessitating a simplified approach for such companies.[18]

Other considerations

The fall back to IAS 39

87. The *IFRS for SMEs* Standard currently includes an option for an entity to choose to apply IFRS Standards (IAS 39) instead of Sections 11 and 12 (the fall back to IAS 39).[19]

---

[17] FRS 102 is a standard based on the *IFRS for SMEs* Standard.

[18] FRC, *Feedback Statement: Consultation Document—Triennial review of UK and Ireland accounting standards—Approach to changes in IFRS*, June 2017.

[19] Paragraph BC106 of the *IFRS for SMEs* Standard explains the reasons for this choice.

88. If the *IFRS for SMEs* Standard is not aligned with IFRS 9, the fall back to IAS 39 should be retained. However, staff does not support retaining the fall back to IAS 39 for the following reasons:

    (a) IAS 39 has been withdrawn and no longer applies under full IFRS Standards;

    (b) retaining the fall back to IAS 39 would make it difficult for entities applying the *IFRS for SMEs* Standard to transition to full IFRS Standards; an

    (c) some SMEIG members do not support retaining the fall back to IAS 39.

89. The staff does not support adding a fall back to IFRS 9 (in addition to the IAS 39 fallback) if the *IFRS for SMEs* Standard is not aligned with IFRS 9. This is because it would leave entities applying the *IFRS for SMEs* Standard with three options to account for financial instruments—Sections 11 and 12, IAS 39 and IFRS 9. This will prove confusing for users of financial statements and will impair comparability.

90. The staff believes the simplified IFRS 9 requirements should be incorporated in the *IFRS for SMEs* Standard, and, a fall back to IFRS 9 should replace the fall back to IAS 39. Allowing a fall back to IFRS 9 might facilitate the transition from the *IFRS for SMEs* Standard to IFRS Standards.

91. Although staff supports replacing the IAS 39 fall back to an IFRS 9 fall back, the Request for Information provides the Board with an opportunity to assess if the fall back is being used in practice and therefore if there is a need for a fall back. The staff recommends that the Request for Information seeks views;

    (a) on the need for the fall back to IAS 39 or IFRS 9 for entities applying the *IFRS for SMEs* Standard; and

    (b) subject to paragraph 91(a), changing the fall back to IAS 39 to fall back IFRS 9; if the requirements on the *IFRS for SMEs* Standard are aligned with IFRS 9.

IFRS 7 disclosures

92. The *IFRS for SMEs* Standards requires entities that opt to apply the recognition and measurement of IAS 39 to comply with the disclosure requirements of Sections 11 and 12, rather than IFRS 7.

93. The Board made this decision when it developed the *IFRS for SMEs* Standard because many of the IFRS 7 disclosures are designed for financial institutions or for entities whose securities are traded in public capital markets, which cannot apply the *IFRS for SMEs* Standard. The financial instruments disclosures in the *IFRS for SMEs* Standard are appropriate for all SMEs, including those that opt to apply IAS 39 for recognition and measurement.[20] The staff agrees with the Board's previous decision.

94. Should the Board change the fall back to IFRS 9, the staff supports retaining the option that entities applying the *IFRS for SMEs* Standard and opting to apply IFRS 9 for recognition and measurement should continue to be exempted from the IFRS 7 disclosures.

---

[20] *IFRS for SMEs* Standard, Basis for Conclusions paragraph BC107.

Questions for the Board

Board members are asked if they agree with the recommendations to seek views, in the Request for Information, on the alignment of the *IFRS for SMEs* Standard with IFRS 9, including:

(a) introducing principles for the classification and measurement of financial assets based on contractual cash flows.

(b) not amending the requirements of the *IFRS for SMEs* Standard for:

  (i) introducing the fair value through other comprehensive income option for equity instruments;

  (ii) the initial recognition of financial instruments at the transaction price;

  (iii) financial liabilities and own credit; and

  (iv) derecognition principles.

(c) the need for requirements on hedge accounting for entities applying the *IFRS for SMEs* Standard; and

  (i) subject to clarifying the need for requirements on hedge accounting, retain the current requirements for hedge accounting in Section 12.

(d) aligning the *IFRS for SMEs* Standard with IFRS 9 simplified approach for impairment of financial assets.

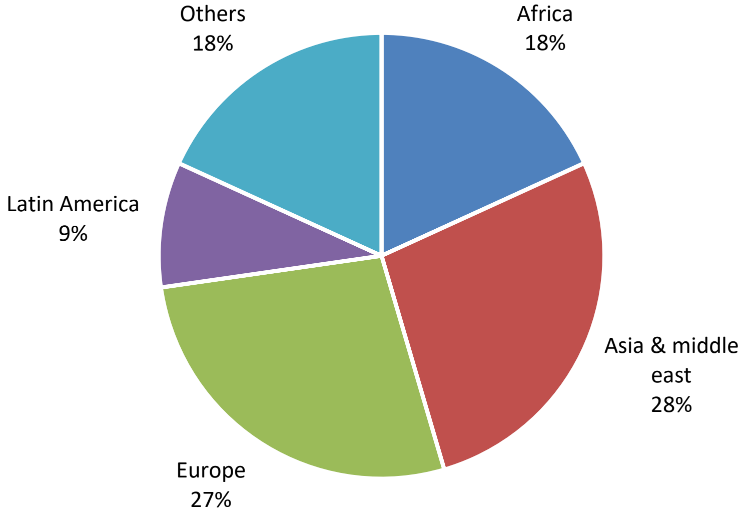
(e) the need for the fall back to IAS 39 or IFRS 9 for entities applying the *IFRS for SMEs* Standard; and

  (i) subject to clarifying the need for the fall back to IAS 39, changing the fall back to IAS 39 to fall back to IFRS 9; if the requirements on the *IFRS for SMEs* Standard are aligned with IFRS 9.

Appendix A—Summary of SMEIG members' views on whether to align the *IFRS for SMEs* Standard with IFRS 9 *Financial Instruments*

A1. On 29 January 2019 a questionnaire was sent to SME Implementation Group (SMEIG) members to seek their views on whether to align the *IFRS for SMEs* Standard with IFRS 9 *Financial Instruments*.

A2. Eleven SMEIG members (42%) responded to the survey. The geographical distribution of the responses received is shown in the chart below.



A3. The main reasons given by SMEIG members (number of members making comments shown in brackets) for aligning the *IFRS for SMEs* Standard with IFRS 9 are:

(a) if the Standards are not aligned, preparers would still be able to use Sections 11 and 12 or IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 (assuming a fall back to IFRS 9 is added) to account for financial instruments although this would be overly complex; (1 respondent)

(b) the alignment of the *IFRS for SMEs* Standard with full IFRS Standards will lead to greater consistency. Furthermore, IFRS 9 is already effective and applied by entities; (2 respondents)

(c) education and training will be more effective and efficient as there are fewer differences between the standards; (1 respondents)

(d) certain requirements of IFRS 9 such as the option to classify equity instruments to be measured and classified at fair value through other comprehensive income and allowing an entity to fair value its own use contracts to avoid complex hedge accounting could be considered to be included in the *IFRS for SMEs* Standard; and (1 respondent)

(e) alignment with the general principles of IFRS 9 would be helpful, especially the solely principle and interest (SPPI) definition for the amortised cost category. (1 respondent)

A4. The main reasons given by SMEIG members (number of members making comments shown in brackets) for not aligning the *IFRS for SMEs* Standard with IFRS 9 are:

(a) Sections 11 and 12 are already simplified versions of IFRS 9 therefore the classification and measurement issue for entities applying the *IFRS for SMEs* Standard is already addressed. However, the fall-back option to IAS 39 should be removed; (3 respondents)

(b) hedge accounting is not relevant for entities applying the *IFRS for SMEs* Standard and the whole section should therefore be excluded from the standard;(2 respondents)

(c) entities have had no experience with implementing IFRS 9; (2 respondents)

(d) introduction of the business model and contractual cash flow characteristics tests may add compliance costs for SMEs without providing benefits. The same can be said about the incurred loss model; (1 respondent)

(e) introduction of IFRS 9 into the *IFRS for SMEs* Standard will require a significant amount of rewriting of the standard which will not be beneficial to entities applying the *IFRS for SMEs* Standard as most non-listed entities only have trade receivables; (2 respondents)

(f) SMEs generally do not have detailed business plans for their financial assets IFRS 9 will therefore be significantly complex for these entities; (1 respondent)

(g) a more principles-based approach in assessing hedge efficiency will not be beneficial for entities applying the *IFRS for SMEs* Standard; (1 respondent)

(h) the existing incurred loss model for measuring impairment is more appropriate for SMEs; (1 respondent)

(i) accounting for financial instruments would be more complex for entities applying the *IFRS for SMEs* Standard if IFRS 9 is introduced into the *IFRS for SMEs* Standard. This could further lead to an inappropriate or incorrect application of the requirements in the Standard; and (4 respondents)

(j) the existing fall-back to IAS 39 option should be replaced by an option to apply IFRS 9 and if so, there may be a need for fewer changes. (1 respondent)

Appendix B—Overview of Sections 11 and 12 and differences between Sections 11 and 12 and IAS 39 and IFRS 9

Background

B1. The *IFRS for SMEs* Standard contains two options for accounting for financial instruments:

- applying the requirements of both Sections 11 and 12 in full; or
- applying the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement*[21] and the disclosure requirements of Sections 11 and 12.

B2. Section 11 focusses on the accounting and reporting of basic financial instruments and Section 12 applies to all other financial instrument issues and hence covers more complex financial instruments and related transactions including hedge accounting.

Overview of Section 11 Basic Financial Instruments

B3. For the purposes of Section 11, basic financial instruments consist of:

- cash;
- debt instruments (such as an account, note, or loan receivable or payable) that meet certain conditions (in particular, returns to the holder are either fixed or are variable on the basis of a single referenced quoted or observable interest rate);
- commitments to receive a loan that cannot be settled net in cash and the loan is expected to meet the same conditions as other debt instruments in this section; and
- investments in non-convertible preference shares and non-puttable ordinary shares or preference shares.

[21] If this option is selected, an entity shall apply the version of IAS 39 that applied immediately prior to IFRS 9 superseding IAS 39.

B4. Deciding whether an asset or liability that arises from a contact is a basic financial instrument accounted for in accordance with Section 11 involves a number of steps:

Step 1: The contract must give rise to a financial asset of one entity and a financial liability or equity instrument of another entity (see paragraph 11.3)

Step 2: The entity must have elected to account for financial instruments in accordance with Sections 11 and 12 (see paragraph 11.2)

Step 3: The financial instrument must not be specifically excluded from the scope of Section 11 (see paragraph 11.7)

Step 4: The financial instrument must be (a) cash or (b) an investment in non-convertible preference shares and non-puttable ordinary shares or preference shares or (c) a debt instrument that satisfies the requirements in paragraph 11.9 or (d) a commitment to receive a loan that cannot be settled net in cash and, when the commitment is executed, is expected to meet the conditions in paragraph 11.9 (see paragraph 11.8).

Recognition

B5. Section 11 requires a financial asset or financial liability to be recognised only when the entity becomes a party to the contractual provisions of the instrument.

Measurement

B6. When first recognised, financial instruments are measured at their transaction price, unless the arrangement constitutes, in effect, a financing transaction. If the arrangement constitutes a financing transaction, the item is initially measured at the present value of the future receipts discounted at a market rate of interest for a similar debt instrument.

B7. After initial recognition an amortised cost model (or in some cases a cost model) is applied to measure all basic financial instruments, except for investments in non-convertible and non-puttable preference shares and non-puttable ordinary shares that are publicly traded or whose fair value can otherwise be measured reliably without undue cost or effort. For such investments, Section 11 requires measurement after initial recognition at fair value with changes in fair value recognised in profit or loss.

B8. Section 11 requires that at the end of each reporting period, an assessment be made of whether there is objective evidence of impairment of any financial asset that is measured at cost or amortised cost.

B9. If there is objective evidence of impairment, an impairment loss is recognised in profit or loss immediately. If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. However, the reversal must not result in a carrying amount of the financial asset that exceeds what the carrying amount would have been had the impairment not previously been recognised.

Overview of 12 Other Financial Instrument Issues

B10. Section 12 requires an entity to recognise a financial asset or financial liability when the entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially recognised at fair value, which is normally the transaction price. Paragraph 12.12 provides further guidance on the treatment of transaction costs and deferred payments as they relate to the initial measurement of financial assets and financial liabilities.

B11. On subsequent measurement, with one exception, all financial instruments within the scope of Section 12 are measured at fair value with changes in fair value recognised in profit or loss. The exception is for equity instruments within the scope of Section 12 not publicly traded whose fair value cannot otherwise be measured reliably without undue cost or effort and contracts linked to such instruments that, if exercised, will result in delivery of the instruments. Such instruments are measured at cost less impairment, rather than at fair value.

B12. Entities are required to apply the guidance on fair value and derecognition contained in Section 11 to financial instruments that fall within the scope of Section 12.

B13. Section 12 also provides guidance on hedge accounting. If specified criteria are met, an entity may designate a hedging relationship between a hedging instrument and a hedged item in such a way as to qualify for hedge accounting.
Hedge accounting permits the gain or loss on the hedging instrument, and on the hedged item, to be recognised in profit or loss at the same time.

B14. The following risks are the only risks for which Section 12 permits hedge accounting:

- interest rate risk of a debt instrument measured at amortised cost;
- foreign exchange or interest rate risk in a firm commitment or a highly probable forecast transaction;
- price risk either of a commodity held or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; and
- foreign exchange risk in a net investment in a foreign operation.

B15. Foreign exchange risk of a debt instrument measured at amortised cost is not in the list above because hedge accounting would not have any significant effect on the financial statements in the light of the accounting requirements of the *IFRS for SMEs* Standard.

Differences between Section 11 and IAS 39 and IFRS 9

Comparison with IAS 39

B16. Applying the *IFRS for SMEs* Standard an entity shall choose to account for all of its financial instruments either:

(a) by applying the provisions of both Sections 11 and 12 in full; or

(b) by applying the recognition and measurement provisions of IAS 39 and the disclosure requirements of Sections 11 and 12.

If an entity chooses to apply (b)

B17. The difference between applying (b) and applying full IFRS Standards is the applicable disclosure requirements. IFRS 7's disclosures are divided into three main categories: significance, risk and transfers. Section 11 includes many of the 'significance' disclosures in IFRS 7. However, the *IFRS for SMEs* Standard includes none of the 'risk' disclosures in IFRS 7. The only disclosure from IFRS 7 relating to 'transfers' that is included in the *IFRS for SMEs* Standard relates to transfers of financial assets that do not qualify for derecognition.

B18. The reasons that the *IFRS for SMEs* Standard omits so many of the IFRS 7 disclosures include:

(c) many of the IFRS 7 disclosures are designed for financial institutions (which are not eligible to use the *IFRS for SMEs* Standard);

(d) many of the IFRS 7 disclosures are designed for entities whose securities trade in public capital markets (which are also ineligible to use the *IFRS for SMEs* Standard); or

(e) in the case of disclosure of fair values for all financial instruments measured at amortised cost, requiring such disclosures would be burdensome for small or medium-sized entities and contrary to the objective of Section 11, which is an amortised cost section for basic financial instruments.

If an entity chooses to apply (a)

B19. There are many differences between Section 11 and full IFRS Standards, including the disclosure differences mentioned for (b) above. Other main differences include:

(a) Classification of financial instruments: Section 11 requires financial instruments that meet specified criteria are measured at cost or amortised cost, with an exemption for a few instruments which are measured at fair value through profit or loss. The fair value option, and the available-for-sale and held-to-maturity classifications in IAS 39 are not available. This therefore removes the requirement to assess management's intentions regarding financial instruments and avoids the need for accounting 'penalties' in Section 11 (for example, tainting provisions for held-to-maturity assets).

(b) Initial recognition: Section 11 requires instruments to be measured at transaction price unless the arrangement constitutes a financing transaction, in which case the cash flows from the instrument are discounted. Under IAS 39, financial instruments are initially measured at fair value. In practice, the different terminology is unlikely to result in any significant difference in value on initial recognition.

(c) Derecognition: Section 11 establishes a simple principle for derecognition. That principle does not rely on the 'pass-through' and 'continuing involvement' provisions that apply to derecognition under IAS 39. The derecognition provisions of the *IFRS for SMEs* Standard would not result in derecognition for some factoring transactions that a small or medium-sized entity may enter into, whereas IAS 39 would result in derecognition.

Comparison with IFRS 9

B20. The recognition and derecognition requirements are largely unchanged between IAS 39 and IFRS 9, so the section on 'initial recognition' and 'derecognition' also applies for IFRS 9.

B21. Unlike Section 11, IFRS 9 has three categories for classification: fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVTOCI) and amortised cost (AC). IFRS 9 does not permit any instruments to be measured at cost.

B22. The classification of financial instruments under IFRS 9 is based on the contractual cash flows of the instrument as well as the business model in which it is held.

Those criteria are different to the criteria used for classification of financial instruments in Section 11.

B23. Generally, applying IFRS 9, the classification is mandatory based on the aforementioned criteria. However, there are some exceptions. An entity can, for example, elect to designate a financial instrument at FVTPL if certain criteria are met. This option is not available in the *IFRS for SMEs* Standard.

B24. The impairment model is based on expected losses and is therefore significantly different from the impairment model in Section 11, which is based on incurred losses. Applying IFRS 9, if credit risk has increased significantly since initial recognition, the entity has to provide for the lifetime expected losses of the instrument. For all other instruments, an entity has to provide for the losses expected within 12 months of the year end on a probability-weighted basis.

B25. The requirements in IFRS 9 for financial liabilities are similar to those of Section 11.

Differences between Section 12 and IAS 39 and IFRS 9

B26. The only disclosures required by Section 12 that are additional to those required in Section 11 are disclosures for entities applying hedge accounting. The only difference from the hedge accounting disclosures in IFRS 7 (which are part of the 'significance' disclosures) is that Section 12 does not require separate disclosure of the amount of the gain or loss on a hedging instrument that has been included in the cost of a non-financial asset or liability; the *IFRS for SMEs* Standard does not permit this accounting treatment and hence the disclosure requirement is not applicable.

Comparison with IAS 39

B27. The key differences between Section 12 and IAS 39 are as follows:

(a) Classification and measurement. If a financial instrument is within the scope of Section 12, the entity is required to measure it at fair value through profit or loss, with the exception of equity instruments whose fair value is not reliably measurable. In contrast, IAS 39 requires entities to classify financial instruments into categories that will then determine the measurement requirements. Applying IAS 39, only financial instruments held for trading are automatically classified and measured at fair value through profit or loss. Section 11 requires the entity to measure the majority of its financial instruments at amortised cost. Therefore, companies that apply Section 12 will not have to apply the requirement in IAS 39 to assess management's intentions regarding financial instruments to classify them.

(b) Derivative financial instruments. Unlike IAS 39, Section 12 does not require separate accounting for 'embedded derivatives'. However, in general, non-financial contracts that include a risk component with economic characteristics not closely related to the host contract will be included within the scope of Section 12 and will be accounted for in their entirety at fair value. This means that for some contracts, Section 12 will require the entire contract to be at fair value, whereas IAS 39 would only require the embedded contract with the risk component to be recognised at fair value.

(c) Hedge accounting. Section 12 focuses on the types of hedging that SMEs are likely to use and only allows hedge accounting for particular risks.

(d) IAS 39 is not as restrictive as regards risks that can qualify for hedge accounting.

(e) Section 12 requires periodic recognition and measurement of hedge ineffectiveness, but under less strict conditions than those in IAS 39.

(f) Section 12 permits hedge accounting only if the hedging instrument is one of four instruments listed in paragraph 12.18. IAS 39 is less restrictive with regards the terms and conditions of hedging instruments. Consequently, hedge accounting cannot be achieved under Section 12 by using debt instruments, such as a foreign currency loan, as hedging instruments, whereas IAS 39 permits this for a hedge of a foreign currency risk. Similarly, hedge accounting is not permitted under Section 12 for an option-based hedging strategy.

(g) Hedge accounting for portfolios is not permitted under Section 12.

Comparison with IFRS 9

B28. The classification and measurement of financial assets applying IFRS 9 is based on the contractual cash flows characteristics of the asset as well as on the business model in which it is held. Such criteria are different to the criteria used for classification of financial instruments in Section 12.

B29. The requirements in IFRS 9 for financial liabilities are similar to those of Section 12.

B30. IFRS 9 makes more hedging relationships eligible for hedge accounting than does Section 12. For example, applying IFRS 9, an entity can designate non-derivative financial instruments as hedging instruments if they are classified as fair value through profit or loss. Also, hedged items can be groups of financial instruments and even include zero-positions or aggregated derivative and non-derivative instruments.

B31. Under IFRS 9, an entity cannot decide to revoke a hedge designation. Such designations can be revoked only if the risk management objective for that designated hedging relationship changes.

Appendix C—Simplifications to IAS 39 requirements in Sections 11 and 12 of the *IFRS for SMEs* Standard

C1. Sections 11 and 12 of the *IFRS for SMEs* Standard are based on IAS 39 *Financial Instruments: Recognition and Measurement* but with these principal simplifications:[22]

(a) **classification of financial instruments—**financial instruments that meet specified criteria are measured at cost or amortised cost, and all others are measured at fair value through profit or loss. The available-for-sale and held-to-maturity classifications in IAS 39 are not available, thereby reducing the complexities associated with these two categories, including assessing intentions and assessing accounting 'penalties' when necessary.

(b) **derecognition—**the *IFRS for SMEs* Standard establishes a simple principle for derecognition that does not rely on the 'pass-through' and 'continuing involvement' requirements for derecognition under IAS 39. Those provisions are complex and relate to derecognition transactions in which SMEs typically do not engage.

(c) **hedge accounting—**the *IFRS for SMEs* Standard focuses on the types of hedging in which SMEs are likely to engage, specifically hedges of:

(i) the interest rate risk of a debt instrument measured at amortised cost;

(ii) the foreign exchange risk or interest rate risk posed by a firm commitment or a highly probable forecast transaction;

(iii) the price risk of a commodity that it holds or in a firm commitment or a highly probable forecast transaction to purchase or sell a commodity; and

(iv) the foreign exchange risk in a net investment in a foreign operation.

[22] Paragraph BC101 of the *IFRS for SMEs* Standard.

(d) **derivative financial instruments**—the *IFRS for SMEs* Standard does not require separate accounting for 'embedded derivatives'. However, non-financial contracts that include an embedded derivative with economic characteristics not closely related to the host contract are accounted for in their entirety at fair value.