IFRS Accounting

Staff paper

Agenda Reference: 1

Emerging Economies Group meeting

Date	**5–6 December 2022**
Project	**Second Comprehensive Review of the *IFRS for SMEs* Accounting Standard**
Topic	**Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard***
Contacts	**Michelle Sansom** (msansom@ifrs.org) **Mostafa Mouit** (mmouit@ifrs.org) **Hazirah Hasni** (hhasni@ifrs.org)

Purpose of this session

- Provide EEG members with an overview of the Exposure Draft *Third Edition of the* IFRS for SMEs *Accounting Standard*
- Seek views from EEG members on the proposals in the Exposure Draft (Questions for EEG members are at the end of each sub-topic)

IFRS Accounting

Agenda

Background — objective, scope and framework for review

Main proposals in the Exposure Draft

Other topics the IASB is seeking feedback on

Next steps

Background

Objective, scope and framework for review

Overview of the *IFRS for SMEs* Accounting Standard

- **Tailored** for entities that do not have public accountability (see slides 10-11) and publish general purpose financial statements (called small and medium-sized entities (SMEs) in the Standard)
- Based on **principles from full IFRS** Accounting Standards
- Focuses on **information needs of lenders and other users** of SMEs’ financial statements

IFRS Accounting

Timeline

First edition	2009	*IFRS for SMEs* Accounting Standard issued and immediately effective		
Second edition	2015	Amendments from the first review issued	2017	Amendments from the first review effective
Third edition	2020	Request for Information on the second review published	2022	Proposed amendments from second review published
	2024 [TBC]	Amendments from the second review expected to be issued	2026 [TBC]	Amendments from the second review expected to be effective

Over 80 jurisdictions require or permit use of the *IFRS for SMEs* Accounting Standard

Objective of the project

- Update the *IFRS for SMEs* Accounting Standard to reflect improvements that have been made in full IFRS Accounting Standards (in the scope of the second comprehensive review) while keeping the Standard simple

Approach

Sought views via the **request for information** published in January 2020

▼

Apply the **framework** for deciding whether, how and when to amend the Standard

▼

Applying the framework and taking into consideration feedback on the request for information, propose improvements to the Standard by publishing the **Exposure Draft**

Scope of the review

Scope	A	Requirements in full IFRS Accounting Standards issued: ▪ since the first review; and ▪ before the first review that did not result in amendments to the Standard in 2015
	B	Other topics brought to the IASB's attention relating to the Standard

Alignment with IFRS Accounting Standard considered	The *Conceptual Framework*	IFRS 13 *Fair value measurement*	Minor amendments to IFRS Accounting Standards and IFRIC Interpretations
	IFRS 3 *Business Combinations*	IFRS 14 *Regulatory Deferral Accounts*	
	IFRS 9 *Financial Instruments*	IFRS 15 *Revenue from Contracts with Customers*	
	IFRS 10 *Consolidated Financial Statements*		
	IFRS 11 *Joint Arrangements*	IFRS 16 *Leases*	

Framework for the Second Comprehensive Review

Relevance to SMEs

Would a change make a difference to the decisions of users?

Simplification

Can appropriate simplifications be made?

Faithful representation

Does outcome faithfully represent economics?

Scope of the Standard

Entities that do not have public accountability

Public Accountability	An entity has public accountability if: a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or b) it holds 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 second criterion).

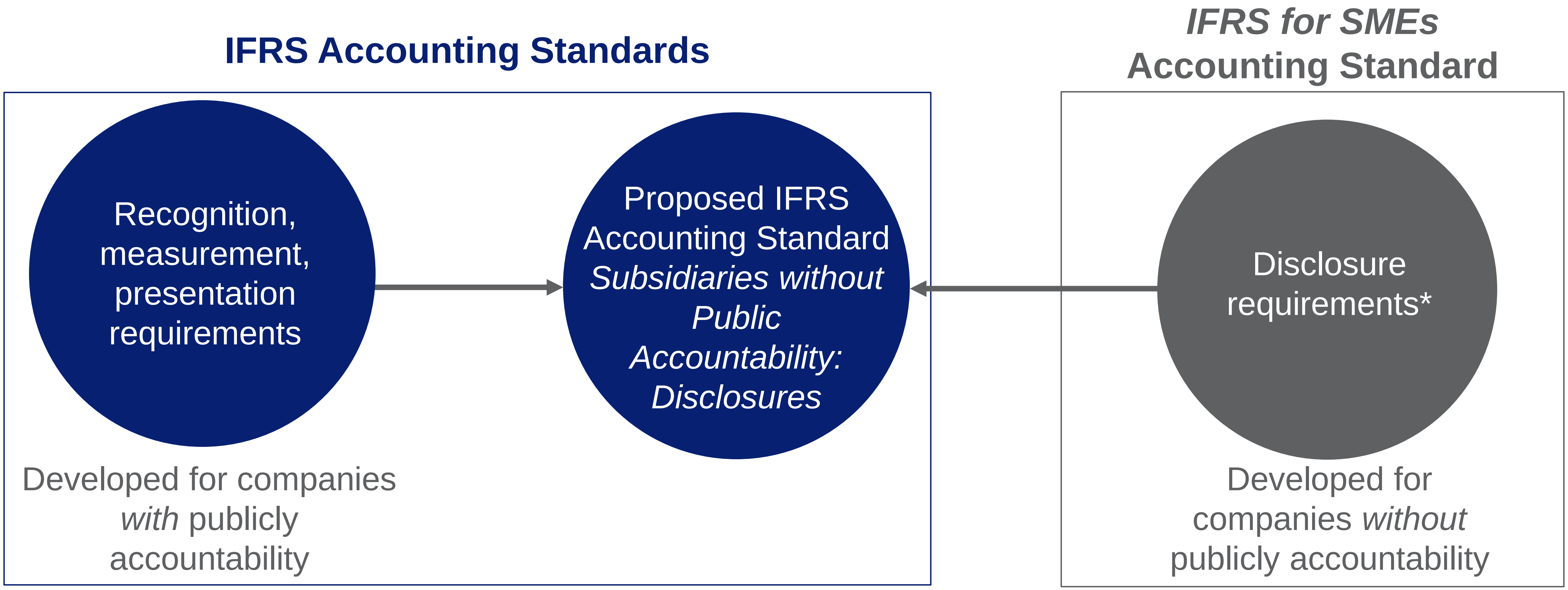
Scope of the Standard

IASB's proposals	• List banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks as **examples** of entities that **often meet the second criterion** of public accountability • Clarify characteristics of entity with public accountability
Entity with these characteristics would usually have public accountability	a) both a high degree of outside interest in the entity and a broad group of users of the entity's financial statements (existing and potential investors, lenders and other creditors) outside the entity (other than owner–managers) who have a direct financial interest in or substantial claim against the entity b) the users in (a) depend primarily on external financial reporting as their means of obtaining financial information about the entity

Questions to EEG members

- Do you agree the amendments will add clarity without changing the intended scope of the Standard?
- Do you agree with the proposal to clarify the definition of public accountability?

Interaction with the proposed IFRS Accounting Standard *Subsidiaries without Public Accountability: Disclosures*



* Disclosure requirements in the *IFRS for SMEs* Accounting Standard was used as a starting point.

Main proposals in the Exposure Draft

Main proposals in the Exposure Draft:

- Concepts and basic principles
- Financial instruments
- Fair value measurement

Concepts and basic principles

Reflect improvements from the 2018 *Conceptual Framework for Financial Reporting*

IASB's proposals

- **Introduce new concepts** on measurement, presentation, disclosure and guidance on derecognition
- **Update definitions** and recognition criteria for assets and liabilities
- **Clarify the concepts** of prudence, stewardship, measurement uncertainty and substance over form
- **Add an overriding principle** that the requirements in other sections of the Standard take precedence over Section 2
- **Retain the concept of 'undue cost or effort'**

Concepts and basic principles

Effect to SMEs

- Improvements will help SMEs when applying judgement in developing accounting policies when the Standard does not specify requirements
- Retaining the concept of ‘undue cost or effort’ enables the IASB to continue providing relief to SMEs in specified circumstances

Effect to Users

- Enhances information in the financial statements of SMEs—this has the potential of improving users’ understanding of information

Question to EEG members

- Do you agree that Section 18 and Section 21 should continue to use the previous definition of an asset and of a liability from Section 2 (based on the 1989 Framework)?

Financial Instruments

Reflecting improvements from <u>*some*</u> aspects of IFRS 9 *Financial Instruments*

IASB's proposals

- **Remove the option** to apply the recognition and measurement requirements of IAS 39
- **Introduce**:
  - an expected credit loss model for some financial assets measured at amortised cost
  - a principle for classification and measurement
  - new requirements for financial guarantee contracts
- **Retain the incurred loss model** for trade receivables and contract assets

A supplementary principle for classification and measurement

Principle	Supplementing the list of examples in Section 11 with a principle based on the contractual cash flow characteristics of the financial asset • A debt instrument whose cash flows are solely payments of principal and interest shall be accounted for at amortised cost (Part I of Section 11) • A debt instrument with contractual terms that introduce exposure to unrelated risks or volatility shall be accounted for at fair value through profit or loss (Part II of Section 11)

Issued financial guarantee contracts

Definition	A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with original or modified terms of a debt instrument
Simplified measurement	Measured initially at transaction price and thereafter at higher of: a) provision for expected credit losses; or b) amount initially recognised, if any, amortised on a straight-line basis over the life of the guarantee

Expected credit losses

Scope	Financial assets measured at amortised cost that are not trade receivables or contract assets
Measurement	Measure expected credit losses of a financial instrument in a way that aligned with the simplified approach in IFRS 9 (lifetime expected credit losses losses) reflects: a) an unbiased and probability-weighted amount that is determined by evaluating alternative 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.

The incurred loss model is retained for impairment of trade receivables and contract assets

Financial Instruments

Effect to SMEs

- Simplified recognition and measurement requirements for issued financial guarantee contracts because such contracts are currently measured at fair value
- No changes for SMEs with simple trade receivables or payables

Effect to Users

- Enhanced comparability by removing the option to apply IAS 39
- Better information from earlier recognition of impairment losses for *some* financial assets measured at amortised cost

Questions to EEG Members

- Do you agree with the proposal to introduce an expected credit model for only *some* financial assets?
- Are you aware of SMEs issuing financial guarantee contracts? If so, do you agree that the IASB's proposals appropriately simplify the initial measurements?

Fair Value Measurement

Reflecting improvements from IFRS 13 *Fair Value Measurement*

IASB's proposals

- **Update the definition** of fair value
- **Update the framework** for measuring fair value, including examples relevant to SMEs
- **Require improved disclosures** about fair value measurements

A new section on fair value measurement is introduced in the Standard

Fair Value Measurement

Effect to SMEs

- No changes to when SMEs are permitted or required to measure an item at fair value
- Clear guidance on how to measure fair value

Effect to Users

- Improved disclosures on fair value
- Improved comparability across entities

IFRS Accounting

Main proposals in the Exposure Draft:

- Business combinations
- The ‘consolidation’ package
- Revenue

Business combinations

Reflecting improvements from IFRS 3 *Business Combinations*

IASB's proposals

- **Update the definition** of a business, including application guidance and illustrative examples
- **Require the acquisition method** of accounting that includes introducing requirements for step-acquisitions and requiring contingent consideration be recognised at fair value
- **Simplify the acquisition method**, including not introducing the option to measure non-controlling interests at fair value

Business combinations

Effect to SMEs

- A clearer and simpler definition of a business will help SMEs to decide when to apply Section 19

- Providing requirements for step acquisitions would remove the need for SMEs to decide on an accounting policy

Effect to Users

- Improved consistency on what is a business combination
- Reduced diversity in how SMEs account for step acquisitions
- Enhanced information to assess the initial investment and performance of business combinations

Questions to EEG members

- Do you agree with the proposal to introduce requirements for the accounting for step acquisitions?
- Do you agree with not introducing the option to measure non-controlling interests at fair value?

The ‘consolidation’ package

Reflecting improvements from *some* aspects of IFRS 10 *Consolidated Financial Statements* and IFRS 11 *Joint Arrangements*

IASB’s proposals

- **Update the definition of control** to align with IFRS 10
- **Retain the rebuttable presumption** that an SME controls an entity if the SME owns a majority of the voting rights of the entity
- **Add new requirements** for partial disposals that result in loss of control—an SME would measure any retained interest at fair value when control is lost
- **Update the definition of joint control** to align with IFRS 11
- **Retain the classifications** of joint arrangements

The ‘consolidation’ package

Effect to SMEs

- A single basis to assess control of an investee
- A principle for joint control aligned with the updated definition of control

Effect to Users

- Increased comparability, usefulness and consistency of information from the proposed single basis for consolidation

Question to EEG members

- Do you agree with retaining the three classifications of joint arrangements (jointly controlled assets, jointly controlled operations and jointly controlled entity)?

Revenue

Reflecting improvements from IFRS 15 *Revenue from Contracts with Customers*

IASB's proposals

- **Introduce a framework for recognising revenue** for goods and services, which requires revenue to be recognised when the customer obtains control of the good or service, based on the five-step model in IFRS 15
- **Simplify requirements of IFRS 15** to make the five-step model easier for SMEs to apply
- **Provide transition relief** to allow SMEs to apply their current revenue recognition policy to contracts already in progress

Revenue

Proposed simplifications to the revenue recognition model in IFRS 15

Step 1	**Contract modifications**	Requirement to account as a separate contract included as an option
Step 2	**‘Performance obligation’ terminology**	Replaced with ‘promise’
	Determining if a good or service is distinct	Included examples and simplified language
	Warranties	Treatment based on the significance of the warranty to the contract
	Customer options for additional goods or services	Accounted for separately when the effects of doing so are significant to the contract
	Principal versus agent	Restricted to three determinative factors

IFRS Accounting

Revenue

Proposed simplifications to the revenue recognition model in IFRS 15

Step 3	**Variable consideration**	Simplified language
	Time value of money	Adjustment required for deferred payment arrangements that constitute a financing transaction
Step 4	**Allocation of a discount/variable consideration**	Allocation based on a principle instead of criteria
Step 5	**Licencing**	Timing of revenue recognition based on a single set of criteria
Contract costs	**Costs to obtain a contract**	Permit an undue cost or effort exemption

Revenue

Effect to SMEs

- A comprehensive framework for determining when and how much revenue to recognise for goods and services
- For many contracts, the revised Section 23 is expected to have little, if any, effect on the amount and timing of revenue recognition

Effect to Users

- Improved consistency in revenue reported for economically similar transactions
- Improved comparability across entities
- Improved disclosures to help understand the amount, timing and uncertainty of revenue and cash flows from contracts with customers

Question to EEG members

- Do you have any comments on the proposed simplifications in slides 30-31?

Other topics the IASB is seeking feedback on

Deleting paragraph 28.19 on employee benefits

The IASB is proposing to delete paragraph 28.19

WHY?

- Feedback identified challenges when applying paragraph 28.19, resulting in diversity of application
- Feedback also provided evidence that a limited number of entities apply paragraph 28.19

Questions to EEG members

- Do you agree that application of the measurement simplifications for defined benefit obligations is limited and, therefore, agree with the IASB's proposal to delete paragraph 28.19?
- If you disagree with IASB's proposal to delete paragraph 28.19, do you agree with an alternative approach that clarifies paragraph 28.19?

Not aligning with IFRS 16 *Leases*

The IASB decided not to align the Standard with IFRS 16 Leases during this review

WHY?

- Costs and efforts for SMEs to apply IFRS 16 requirements (at this stage of IFRS 16's life cycle) might not be justified
- Findings from the post-implementation review of IFRS 16 and application questions may provide additional information about the costs and benefits of aligning with IFRS 16

Question to EEG members

- 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?

Recognition and measurement of development costs

The IASB is seeking views on whether it should introduce an accounting policy option that allows **recognition** of intangible assets arising from development costs

WHY?

- Feedback on this comprehensive review questioned the simplification to require all development costs to be recognised as expenses due to cost–benefit
- SMEIG members agreed with amending the recognition and measurement requirements for development costs subject to the criteria in IAS 38

Question to EEG members

- What are your views on introducing an accounting policy option that permits an entity applying the Standard to recognise intangible assets arising from development costs that meet the criteria in paragraphs 57(a)–(f) of IAS 38?

IFRS Accounting

Next steps

IFRS Accounting

Next steps

September 2022	March 2023	Q2 2023	2024
Publication of the Exposure Draft	Deadline for comments	Discussion of feedback summary	Expected publication of amendments to the *IFRS for SMEs* Accounting Standard

Consultation period

Get involved in this consultation

Open for comment until 7 March 2023

Access the consultation documents:

- Exposure Draft
- Basis for conclusions
- Snapshot

For further details, please visit the project page - Second Comprehensive Review of the *IFRS for SMEs* Accounting Standard

or

Scan the QR Code.

Tell us what you think:

- Submit a comment letter at https://www.ifrs.org/projects/work-plan/2019-comprehensive-review-of-the-ifrs-for-smes-standard/exposure-draft-and-comment-letters/
- Send us an email at sme@ifrs.org

Thank you!

For more details about the project and the Exposure Draft, please refer to the project page on the IFRS website

IFRS Accounting

Follow us online

ifrs.org

@IFRSFoundation

IFRS Foundation

International Accounting Standards Board