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SMEs

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Exposure Draft

IFRS for SMEs® Accounting Standard

Basis for Conclusions and Illustrative Financial Statements on

Third edition of the *IFRS for SMEs* Accounting Standard

Comments to be received by 7 March 2023

International Accounting Standards Board

IASB/ED/2022/1

Exposure Draft Third Edition of the
IFRS for SMEs *Accounting Standard*
Basis for Conclusions
Illustrative Financial Statements

Comments to be received by 7 March 2023

This Basis for Conclusions and Illustrative Financial Statements accompanies the Exposure Draft IASB/ED/2022/1 *Third edition of the* IFRS for SMEs *Accounting Standard* (published September 2022; see separate booklet). It is published by the International Accounting Standards Board (IASB) for comment only. Comments need to be received by 7 March 2023 and should be submitted by email to commentletters@ifrs.org or online at https://www.ifrs.org/projects/open-for-comment/.

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Basis for Conclusions on Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard*

This Basis for Conclusions accompanies, but is not part of, Exposure Draft Third edition of the *IFRS for SMEs* Accounting Standard. *It summarises the considerations of the International Accounting Standards Board (IASB) when developing the Exposure Draft. Individual IASB members gave greater weight to some factors than to others.*

Introduction

BC1 In 2009, the International Accounting Standards Board (IASB) issued the first edition of the *International Financial Reporting Standard for Small and Medium-sized Entities* (the Standard). The Standard:

(a) is intended to apply to the general purpose financial statements and other financial reporting of entities that do not have public accountability (called small and medium-sized entities (SMEs) in the Standard); and

(b) is based on full IFRS Accounting Standards with modifications to reflect the needs of users of SMEs' financial statements and cost–benefit considerations.

BC2 In 2015, the IASB:

(a) completed its first comprehensive review of the Standard by issuing *2015 Amendments to the IFRS for SMEs*, which became effective in 2017; and

(b) issued a second edition of the Standard, incorporating the 2015 amendments.

BC3 In 2019, the IASB commenced its second comprehensive review of the Standard, in line with the objective of commencing a comprehensive review approximately two years after the effective date of the amendments to the Standard resulting from a previous comprehensive review.

BC4 This Basis for Conclusions explains the IASB's rationale for proposing amendments to the Standard to reflect new requirements in full IFRS Accounting Standards, and other matters brought to the IASB's attention since it issued the second edition of the Standard. This Basis for Conclusions also explains the IASB's rationale for not proposing amendments to the Standard to reflect other new requirements in full IFRS Accounting Standards.

Background

Periodic reviews of the Standard

BC5 The IASB maintains the Standard through periodic review. The Preface to the Standard states that the IASB expects to propose amendments to the Standard by publishing an omnibus exposure draft periodically, but not more frequently than approximately once every three years. In developing these

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exposure drafts, the IASB expects to consider new and amended IFRS Accounting Standards as well as specific issues that have been brought to its attention regarding the application of the Standard. Occasionally, the IASB might identify an urgent matter that would require it to consider amending the Standard outside the periodic review process. However, such occasions are expected to be rare.

Request for Information

BC6 In January 2020, the IASB published Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* as a first step in its second comprehensive review. The objective of the Request for Information was to seek views on whether and, if so, how aligning the Standard with new and amended full IFRS Accounting Standards in the scope of the review could better serve users of financial statements prepared applying the Standard without causing undue cost or effort for SMEs.

BC7 The Request for Information was in three parts:

(a) the framework the IASB developed for the second comprehensive review (Part A of the Request for Information);

(b) sections of the Standard that could be aligned with new and amended requirements in full IFRS Accounting Standards in the scope of the review (Part B of the Request for Information); and

(c) topics omitted from the Standard and whether, in relation to these topics, the Standard could be aligned with full IFRS Accounting Standards; and topics related to application of the Standard (Part C of the Request for Information).

BC8 The Request for Information was open for comment for 270 days (extended from 180 days because of the covid-19 pandemic). During the comment period, IASB members and staff gathered feedback from stakeholders across different jurisdictions:

(a) IASB members and staff met remotely with more than 2,000 stakeholders in approximately 15 individual and group meetings in more than 90 jurisdictions across the world;

(b) the IASB also obtained feedback from:

    (i) 66 comment letters;

    (ii) 30 completed online surveys—the online survey replicated the questions in the Request for Information;

    (iii) 54 completed user surveys—the user survey included 13 questions focused on the needs of users of SMEs' financial statements; and

    (iv) 12 interviews with users of SMEs' financial statements.

SMEIG meetings and recommendations

BC9 The SME Implementation Group (SMEIG) advises the IASB on implementing and applying the Standard. It makes recommendations to the IASB throughout this comprehensive review of the Standard. Members of the SMEIG are appointed by the Trustees of the IFRS Foundation after a public call for nominations.

BC10 Between February 2021 and January 2022, the SMEIG met to discuss the feedback on the Request for Information and develop recommendations for the IASB on whether to propose amendments to the Standard. The SMEIG's recommendations were summarised in reports published on the IFRS Foundation website and considered by the IASB when it developed the proposals on the topics discussed by the SMEIG.

Scope of the Standard

Definition of public accountability

BC11 At the start of this second comprehensive review, the IASB engaged with its consultative groups and national standard-setters on whether to permit exceptions to the definition of public accountability to allow some publicly accountable entities to apply the Standard. Stakeholders agreed with the IASB's view that changes to the scope of the Standard might require other changes that would increase the complexity of the Standard. Furthermore, stakeholders raised concerns about the difficulty of clearly defining the group of entities with public accountability that should be permitted to apply the Standard.

BC12 Because of the feedback from both the first comprehensive review (see paragraphs BC178–BC181 of the Basis for Conclusions on the Standard[1]) and from stakeholder engagement during this second comprehensive review, the IASB decided it was unlikely that responses to the Request for Information would lead the IASB to change its previous conclusions. Therefore, the IASB decided not to ask a question in the Request for Information on amending the scope of the Standard to permit exceptions to the definition of public accountability. Nevertheless, a few respondents to the Request for Information suggested that the scope of the Standard be widened by relaxing or removing the second criterion for public accountability in paragraph 1.3(b) of the Standard. These respondents said that the Standard would improve the financial reporting of credit unions and smaller financial institutions, especially in developing countries.

BC13 The IASB observed that it had considered this perspective during the first comprehensive review and these respondents provided no new information. The IASB also noted the concerns raised by consultative groups and national standard-setters about increasing the complexity of the Standard and defining a wider scope of entities that could apply the Standard (see paragraph BC11). If

1 References to 'the Basis for Conclusions on the Standard' within this document are references to the Basis for Conclusions on the 2015 version of the Standard.

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the scope were widened to include a sub-group of financial institutions, the IASB considered this might lead to pressure to include additional requirements from the newer IFRS Accounting Standards being considered during this review. For example, incorporating additional requirements from IFRS 9 *Financial Instruments* and IFRS 13 *Fair Value Measurement* to cater for more complex financial instruments, and incorporating risk disclosures from IFRS 7 *Financial Instruments: Disclosures*. Such additional requirements may include hedge accounting requirements and disclosures, and requirements to use the general model in IFRS 9 to calculate expected credit losses and disclose credit risk management practices. Therefore, the IASB decided not to propose widening the scope of the Standard to include some publicly accountable entities.

BC14 Nevertheless, feedback on the Exposure Draft ED/2021/7 *Subsidiaries without Public Accountability: Disclosures*, issued in July 2021, indicated some concerns about applying the definition of public accountability.[2] In particular, some respondents to ED/2021/7 disagreed with the statement in paragraph 1.3(b) of the Standard that 'most' banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks hold assets in a fiduciary capacity for a broad group of outsiders as a primary business, and hence have public accountability. These concerns were raised mainly in relation to insurance companies. A few respondents were of the view that premiums collected by an insurance company in exchange for a contractual promise to indemnify the customer for a possible future event belong to the insurance company and are not held and managed in a fiduciary capacity by the insurance company. Some respondents asked for guidance on the term 'fiduciary capacity'.

BC15 The IASB observed that there is a high degree of public interest in the financial reports of all non-captive insurance companies (insurance companies that insure the risks of parties outside their group of entities) because:

(a) the policyholders risk financial loss if an insured event occurs and the insurance company cannot pay the claim.

(b) the policyholders are outsiders who cannot demand information for themselves. That is why insurance companies are regulated—like banks, mutual funds, securities brokers and dealers, and other financial institutions.

BC16 The IASB also noted that the Standard includes no specific requirements for insurance contracts or complex financial instruments and, therefore, may not be suitable for more complex financial institutions. Nevertheless, the IASB agreed with respondents that specifying how often the entities in paragraph 1.3(b) of the Standard hold assets in a fiduciary capacity is unhelpful within the definition of public accountability and it would be better

2 In July 2021, the IASB issued Exposure Draft ED/2021/7 *Subsidiaries without Public Accountability: Disclosures*, which sets out the IASB's proposal for a new IFRS Accounting Standard that would permit a subsidiary that does not have public accountability to apply reduced disclosure requirements when applying full IFRS Accounting Standards. The description of 'public accountability' in ED/2021/7 is based on the definition and supporting guidance in paragraphs 1.3–1.4 of the *IFRS for SMEs* Accounting Standard.

to clarify why those entities often have public accountability. Consequently, the IASB is proposing to amend paragraph 1.3(b) to instead list banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks as examples of entities that often meet the second criterion. Nevertheless, the IASB noted that this amendment is not intended to be a relaxation of the criterion in paragraph 1.3(b).

BC17 Furthermore, to help jurisdictions better understand the basis for the definition of 'public accountability' and apply that definition consistently, the IASB is proposing to clarify why the entities in paragraph 1.3(b) would often be considered to have public accountability. In particular, the IASB is proposing to clarify that an entity with these characteristics would usually have public accountability:

(a) there is 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) who have a direct financial interest in, or substantial claim against, the entity.

(b) these users depend primarily on external financial reporting as their means of obtaining financial information about the entity. These users need financial information about the entity but lack the power to demand the information for themselves.

The IASB's view is that full IFRS Accounting Standards are intended to meet the needs of these users.

BC18 The IASB expects that the proposed amendments explained in paragraphs BC16–BC17 will add clarity, without changing the intended scope of the Standard. However, in the Invitation to Comment on the Exposure Draft, the IASB is asking whether respondents agree with this expectation and with the proposed clarification.

BC19 The IASB observed that it discussed providing guidance on, or defining, the term fiduciary capacity during the first comprehensive review (see paragraph BC183 of the Basis for Conclusions on the Standard) and concluded that it would be difficult to develop guidance that would be applicable, translatable and capable of being consistently applied across all jurisdictions applying the Standard. The IASB also noted that the Standard is established in many jurisdictions, using the definition of public accountability. Consequently, including a definition of 'fiduciary capacity' in the Standard now could create problems in jurisdictions that have already determined which types of entities in that jurisdiction have public accountability, if such determinations are inconsistent with any new definition.

Name of the Standard

BC20 In the Request for Information, the IASB did not ask about amending the name of the *IFRS for SMEs* Accounting Standard. However, some respondents raised the name as an additional issue they would like to bring to the IASB's attention. These respondents said the name of the Standard is misleading because the Standard does not prescribe size criteria and large, non-publicly

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accountable entities are eligible to use the Standard. The IASB observed that it had discussed the alternative names suggested by these respondents when it developed the Standard.

BC21 The IASB decided after several rounds of discussion that the best alternative for the name of the Standard was 'IFRS for SMEs'.[3] The IASB observed that the name 'IFRS for SMEs' is established as a recognised brand and changes to the name would risk weakening this brand. The SMEIG advised the IASB that the name has been incorporated in national law in many jurisdictions and changing the name could have other consequences. The IASB is of the view that, to justify changing the name, it would need to have evidence of either a better alternative or a change in the scope of the Standard. The IASB also observed that changing the name of the Standard could be confusing without a change in the scope of the Standard. Therefore, the IASB is not proposing to change the name 'IFRS for SMEs'.

Scope of this review

BC22 The scope of this second comprehensive review includes:

(a) IFRS Accounting Standards, amendments to IFRS Accounting Standards and IFRIC Interpretations issued since the first comprehensive review of the Standard;

(b) IFRS Accounting Standards and IFRIC Interpretations issued before the first comprehensive review that did not result in amendments to the *IFRS for SMEs* Accounting Standard; and

(c) general implementation experience and issues arising from applying the Standard.

BC23 The second comprehensive review includes many IFRS Accounting Standards in its scope, in part, because it re-examines some IFRS Accounting Standards from the scope of the first comprehensive review. IFRS Accounting Standards in the scope of this review are:

(a) the *Conceptual Framework for Financial Reporting* (issued in 2018);

(b) IFRS 3 *Business Combinations*;

(c) IFRS 9 *Financial Instruments*;

(d) IFRS 10 *Consolidated Financial Statements*;

(e) IFRS 11 *Joint Arrangements*;

(f) IFRS 13 *Fair Value Measurement*;

(g) IFRS 14 *Regulatory Deferral Accounts*;

(h) IFRS 15 *Revenue from Contracts with Customers*;

(i) IFRS 16 *Leases*; and

(j) IAS 19 *Employee Benefits* (revised in 2011).

3 See paragraphs BC78–BC79 of the Basis for Conclusions on the Standard.

BC24 Amendments to IFRS Accounting Standards and IFRIC Interpretations in the scope of this review are shown in Tables A1–A2 accompanying this Basis for Conclusions.

BC25 In this review, the IASB did not:

(a) consider ongoing projects on the IASB's agenda that it expects will result in changes to full IFRS Accounting Standards. Until the IASB issues an IFRS Accounting Standard, an amendment to an IFRS Accounting Standard or an IFRIC Interpretation its views are tentative and subject to change.

(b) ask for views in the Request for Information on amending the scope of the Standard (see paragraph BC12).

BC26 The IASB is proposing in this review that in a future review of the Standard, it consider whether to amend the Standard:

(a) to include requirements for regulatory assets and regulatory liabilities;

(b) to include requirements for cryptocurrency; and

(c) to align the Standard with IFRS 16 *Leases*.

Approach to the second comprehensive review

BC27 The IASB developed the Standard from full IFRS Accounting Standards. The Standard was based on the 1989 *Framework for the Preparation and Presentation of Financial Statements* (1989 *Framework*) and the principles and requirements in full IFRS Accounting Standards. These principles and requirements were simplified for SMEs based on users' needs and cost–benefit considerations. As part of this review, the IASB wanted to understand if it should continue to develop the Standard in this way (referred to as the alignment approach) or whether it should only consider issues stakeholders raised about the Standard. The Request for Information explained that IASB members had different views on how to approach this review.

BC28 The IASB decided that, subject to further evidence, it should continue with the alignment approach and treat alignment with full IFRS Accounting Standards as the starting point for developing the Request for Information, while applying judgement in deciding whether and, if so, how that alignment should take place.

BC29 To help the IASB apply judgement in deciding whether and, if so, how the Standard should be aligned with full IFRS Accounting Standards in the scope of the second comprehensive review, the IASB applied three principles:

(a) relevance to SMEs;

(b) simplicity; and

(c) faithful representation.

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BC30 The IASB determines relevance to SMEs by assessing whether the problem addressed by a new requirement in full IFRS Accounting Standards (in the scope of the review) would make a difference in the decisions of users of financial statements prepared applying the Standard.

BC31 Applying the principle of simplicity involves looking at the new requirements in the IFRS Accounting Standards, amendments to IFRS Accounting Standards and IFRIC Interpretations that have satisfied the relevance condition and then assessing what simplifications are appropriate. Paragraph BC16 of the Basis for Conclusions on the Standard sets out five ways the requirements in full IFRS Accounting Standards can be simplified. They are:

(a) omitting some topics;

(b) permitting only the simplest option if an IFRS Accounting Standard permits options;

(c) simplifying recognition and measurement requirements;

(d) reducing disclosures; and

(e) simplifying language.

BC32 The principle of faithful representation is intended to help the IASB assess whether financial statements prepared applying the Standard would faithfully represent the substance of economic phenomena in words and numbers. Simplifications that would result in financial statements that do not meet this criterion could damage the quality of information reported to users.

BC33 The Request for Information sought views on the alignment approach. Overall, stakeholders who provided feedback on the alignment approach and the principles for applying the alignment approach agreed with continuing to base the Standard on full IFRS Accounting Standards.

BC34 Some stakeholders queried whether the alignment principles:

(a) adequately acknowledged the limited resources available to SMEs given the complexity of some requirements in full IFRS Accounting Standards, particularly in IFRS 9 *Financial Instruments* and IFRS 16 *Leases*; and

(b) appropriately assessed the costs and benefits of any possible amendment to the Standard, considering the costs to SMEs and the capabilities of SMEs to provide financial information.

BC35 The IASB acknowledged these concerns but noted that, in applying the alignment approach to developing proposed amendments to the Standard, the alignment principles would involve the IASB researching simplifications to reduce complexity. This research would be considered alongside feedback on the Request for Information and the advice of SMEIG members.

BC36 The IASB noted that, in applying the principle of relevance to SMEs, it would only propose amendments to the Standard if it assessed that a new requirement in full IFRS Accounting Standards would make a difference to users of SMEs' financial statements. This assessment would, itself, be part of the cost–benefit considerations. However, acknowledging the limited resources of entities applying the Standard, the IASB decided it would consider the costs and benefits of aligning the Standard separately with each new requirement in full IFRS Accounting Standards in the scope of the review.

BC37 The IASB also decided it would specify how the alignment principles are met when proposing an amendment to the Standard.

Proposed amendments

Section 2 *Concepts and Pervasive Principles*

Align with the *Conceptual Framework for Financial Reporting*

BC38 Section 2 *Concepts and Pervasive Principles* describes the objective of financial statements of SMEs and sets out the concepts and basic principles underlying the financial statements of SMEs. Section 2 is based on the 1989 *Framework*, which the IASB revised and replaced with the *Conceptual Framework for Financial Reporting* (2018 *Conceptual Framework*) in March 2018. In the Request for Information, the IASB asked for views on aligning Section 2 with the 2018 *Conceptual Framework*.

BC39 The 2018 *Conceptual Framework*:

(a) has new:

  (i) concepts on measurement, including factors to be considered when selecting a measurement basis;

  (ii) concepts on presentation and disclosure, including when to classify income and expenses in other comprehensive income; and

  (iii) guidance on when assets and liabilities are derecognised from financial statements;

(b) has updated:

  (i) the definitions of an asset and a liability;

  (ii) the criteria for recognising assets and liabilities in financial statements; and

(c) has clarified the concepts of 'prudence', 'stewardship', 'measurement uncertainty', and 'substance over form'.[4]

BC40 Respondents to the Request for Information and the SMEIG agreed with aligning the Standard with the 2018 *Conceptual Framework* and making any appropriate amendments to other sections of the Standard. Therefore, the Exposure Draft sets out the IASB's proposals for a revised Section 2, which is aligned with the 2018 *Conceptual Framework.* The IASB did not apply the alignment principles to Section 2, because the alignment principles are not

4 Substance over form refers to the requirement for financial information to faithfully represent the substance of the phenomena, which could differ from the legal form.

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directly applicable to Section 2. The IASB did not discuss these principles but considered the overall assessment of the costs and benefits of developing amendments to the Standard to align it with the 2018 *Conceptual Framework*.

Status of Section 2

BC41 The 2018 *Conceptual Framework* is not an IFRS Accounting Standard, and nothing in the *Conceptual Framework* overrides any IFRS Accounting Standard or any requirement in an IFRS Accounting Standard. In contrast, Section 2 is part of the Standard meaning that it has equal authority with other sections in the Standard. The IASB is proposing to retain the revised Section 2 as part of the Standard.

BC42 Some respondents and some SMEIG members—acknowledging the different status of the 2018 *Conceptual Framework* in full IFRS Accounting Standards compared to the status of the revised Section 2 in the Standard—were concerned about potential inconsistencies between the revised Section 2 and other sections in the Standard.

BC43 The IASB noted that the inconsistencies identified—in developing the 2018 *Conceptual Framework*—between any IFRS Accounting Standards and the 2018 *Conceptual Framework* could apply to the equivalent sections of the Standard when aligning Section 2 with the 2018 *Conceptual Framework*. Therefore, the IASB applied the approach it had applied to full IFRS Accounting Standards when it issued the 2018 *Conceptual Framework*; that is:

(a) as a first step, the proposed revised Section 2 would not automatically lead to proposed changes to other sections of the Standard. However, the IASB is proposing necessary clarifications to some sections. The IASB is also proposing to add an override paragraph in Section 2 emphasising that the requirements in the other sections take precedence over the requirements in the revised Section 2.

(b) as a second step, undertaking a review for potential inconsistencies between the revised Section 2 and other sections of the Standard.

BC44 As part of the second step, the IASB performed a review of potential inconsistencies during development of the Exposure Draft. The IASB is not proposing amendments to the Standard as a result of the review for potential inconsistencies between the revised Section 2 and other sections of the Standard—except for clarifying amendments explained in paragraphs BC45–BC47.

Review of potential inconsistencies

Proposed clarifications

BC45 The IASB observed that the recognition criteria in Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill* refer to the recognition criteria in Section 2.

BC46 The IASB is proposing to revise Section 2 and thereby update the recognition criteria. Therefore, the IASB is also proposing to delete the references to Section 2 from Section 17 and Section 18 to avoid creating inconsistencies.

BC47 Section 18 and Section 21 *Provisions and Contingencies* rely on the 1989 *Framework* definitions of an asset and of a liability. Because the IASB is proposing to revise Section 2 to align it with the 2018 *Conceptual Framework* there could be inconsistencies with these sections in the amended Standard. The IASB noted that IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 38 *Intangible Assets* include the definition of an asset from the 1989 *Framework*. To avoid unintended consequences the IASB is proposing these sections continue to use the definitions of an asset and of a liability from the previous version of Section 2, which were based on the 1989 *Framework*.

Proposing no changes

BC48 Other inconsistencies considered by the IASB included:

(a) faithful representation versus reliability (paragraph BC49);

(b) Section 19 *Business Combinations and Goodwill* (paragraphs BC151–BC156);

(c) Section 20 *Leases* (paragraph BC243); and

(d) Section 22 *Liabilities and Equity* (paragraph BC50).

BC49 Section 2 uses the term 'reliability' to describe what is referred to broadly as faithful representation in the revised Section 2. The IASB is not proposing to retain the term 'reliability' as a qualitative characteristic in the revised Section 2. However, some sections of the Standard use the term 'reliability' in this way. The IASB observed that it would be difficult to determine when the term 'reliability' was being used in the broader sense of 'faithful representation' or being used in the narrower sense of 'measurement uncertainty'. Therefore, the IASB was of the view that replacing the term 'reliability' with 'faithful representation' could result in unintended consequences in the sections. The IASB also noted that it had decided not to make such changes in full IFRS Accounting Standards and that the Standard should not move ahead of full IFRS Accounting Standards. Therefore, the IASB is not proposing to replace the term 'reliability' with the term 'faithful representation' in the other sections of the Standard.

BC50 Some of the classification requirements in Section 22 are inconsistent with the definitions of a liability and equity in the revised Section 2. However, the IASB noted that this inconsistency also exists between IAS 32 *Financial Instruments: Presentation* and the 2018 *Conceptual Framework*. In developing the 2018 *Conceptual Framework*, the IASB decided not to propose changes to the definitions to eliminate the inconsistencies in IAS 32 because the IASB had a project underway, *Financial Instruments with Characteristics of Equity*, which is exploring how to distinguish liabilities from equity claims. The IASB is of the view that the Standard should not move ahead of full IFRS Accounting Standards, and therefore is not proposing to eliminate such inconsistencies during this review of the Standard.

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Undue cost or effort

BC51 Section 2 also includes the concept of 'undue cost or effort', which is available as an 'undue cost or effort' exemption to an entity applying the Standard in specified circumstances. This concept is not in the 2018 *Conceptual Framework*. In the Request for Information, the IASB asked if it should retain the 'undue cost or effort' concept. Respondents and the SMEIG agreed with retaining the concept of 'undue cost or effort' because it provides a mechanism to balance the costs and benefits of the requirements in the Standard and alleviates the burden for SMEs applying the Standard. The IASB agreed with this feedback and is proposing to retain the concept of 'undue cost or effort' unchanged in the revised Section 2.

Section 9 *Consolidated and Separate Financial Statements*

Definition of control

BC52 In the first comprehensive review of the Standard, the IASB consulted with stakeholders on aligning the definition of control and the guidance on its application in Section 9 *Consolidated and Separate Financial Statements* with IFRS 10 *Consolidated Financial Statements*, but decided not to align, because IFRS 10 had only recently become effective.

BC53 The definition of control in Section 9 was aligned with the definition in IAS 27 *Consolidated and Separate Financial Statements* when the IASB developed the Standard and included some of the requirements in SIC-12 *Consolidation—Special Purpose Entities*. IFRS 10 replaced the requirements in IAS 27 and SIC-12 with a control model as the single basis for consolidation.

BC54 The IASB completed its Post-implementation Review of IFRS 10 in June 2022 and concluded that IFRS 10 is working as intended. The Post-implementation Review was undertaken simultaneously with the second comprehensive review. Therefore, the IASB considered the evidence from the Post-implementation Review to help it develop the proposals in the Exposure Draft.

BC55 The IASB had already judged consolidated financial statements to be relevant to SMEs by including a section on this topic in the Standard. Therefore, in the Request for Information, the IASB asked whether aligning the definition of 'control' and using that definition as the single basis for consolidation (control model) would facilitate greater consistency between financial statements prepared applying the Standard.

BC56 Many respondents to the Request for Information agreed with aligning the definition of 'control' with IFRS 10. The IASB agreed with respondents that the definition of 'control' is important, and that alignment would facilitate greater consistency between financial statements prepared applying the Standard. In applying its faithful representation principle, the IASB referred to its conclusion in the Post-implementation Review that IFRS 10 is working as intended, which provided evidence that using the control model as the single basis for consolidation improves faithful representation. Therefore, the IASB is proposing to align the definition of 'control' in Section 9 with that in IFRS 10.

BC57 In applying its simplicity principle, the IASB observed that using the control model as the single basis for consolidation is itself a simplification. The IASB acknowledges the feedback on the Post-implementation Review that assessing control requires judgement. The extent of the judgement required depends on the complexity of the transaction and can, sometimes, be significant. However, some respondents to the Request for Information said entities that apply the Standard rarely engage in complex transactions.

BC58 The IASB also agreed with many respondents' views on retaining the rebuttable presumption in paragraph 9.5 of the Standard and updating it to state that control is presumed to exist when the parent entity owns, directly or indirectly through subsidiaries, a majority of the voting rights of an entity. The rebuttable presumption is a simplification to the control model. The IASB is of the view that retaining the rebuttable presumption will continue to ease the application of the control model.

Investment entities

BC59 IFRS 10 requires an investment entity to measure an investment in a subsidiary at fair value through profit or loss and not consolidate such a subsidiary. The Standard has no equivalent requirement. In the Request for Information, the IASB explained its view that, because of the scope of the Standard, few entities would qualify as investment entities as defined in IFRS 10. That is, the IASB's assessment was that this topic did not meet the principle of relevance to SMEs. Therefore, in the Request for Information, the IASB asked for views on omitting from the Standard the requirement that an investment entity measures an investment in a subsidiary at fair value through profit or loss.

BC60 Respondents to the Request for Information agreed with the IASB's view that this topic did not meet the relevance principle because few entities eligible to apply the Standard would qualify as investment entities. However, some SMEIG members said some high-net-worth individuals hold assets in entities that would meet the definition of an 'investment entity'. These SMEIG members recommended that the IASB propose introducing the requirement that an investment entity measures investments in subsidiaries at fair value through profit or loss. However, the IASB decided against proposing requirements for investment entities in the Exposure Draft, based on its initial view and on the feedback on the Request for Information.

Loss of control

BC61 When a parent entity loses control but retains an investment in a former subsidiary, paragraph 9.19 of the Standard requires the carrying amount of the investment at the date control is lost to be the cost on initial measurement of the retained investment.

BC62 The IASB is proposing to align paragraph 9.19 with paragraph 25(b) of IFRS 10 to require an entity to measure its retained interest in the former subsidiary at fair value at the date control is lost, with any resulting gain or loss recognised in profit or loss. Measuring the investment at fair value reflects the IASB's view that losing control of a subsidiary is a significant economic event.

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The parent–subsidiary relationship ceases to exist and an investor–investee relationship that differs significantly from the former parent–subsidiary relationship begins. The IASB also noted that this proposal is consistent with its decision to propose amendments to Section 19 to introduce requirements for an acquisition achieved in stages (step acquisitions) as set out in IFRS 3 (these amendments would require an SME to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss in profit or loss).

Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instrument Issues* (combined and renamed Section 11 *Financial Instruments*)[5]

BC63 In July 2014, the IASB issued IFRS 9 *Financial Instruments*, completing its project to replace IAS 39 *Financial Instruments: Recognition and Measurement* with a principle-based Standard.

Classifying and measuring financial assets

BC64 IFRS 9 applies a principle-based approach to classifying financial assets based on: (a) the contractual cash flow characteristics of the financial asset; and (b) the business model for managing the financial asset. Section 11 *Basic Financial Instruments* provides a list of examples of basic financial instruments and sets out the conditions a debt instrument is required to satisfy to be classified as a basic financial instrument and, therefore, be measured at amortised cost. In the Request for Information, the IASB asked for views on supplementing the list of examples in paragraphs 11.9A–11.11 of the Standard with a principle based on the contractual cash flow characteristics of the financial asset.

BC65 The IASB observed that supplementing the list of examples in Section 11 with such a principle would provide a clear rationale for classifying financial assets and measuring them either at amortised cost or fair value. Therefore, the principle would assist entities if a financial asset does not match the characteristics in any of the examples and would provide relevant guidance to entities applying the Standard.

BC66 In supplementing the list of examples in Section 11 with a principle based on the contractual cash flow characteristics, the IASB decided it should simplify the classification and measurement requirements for financial assets in IFRS 9 by:

(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

5 The IASB is proposing to combine Section 11 and Section 12 to create a revised Section 11, which is structured in two parts: Part I *Basic Financial Instruments* and Part II *Other Financial Instrument Issues*.

(b) removing the option to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument (FVOCI election).[6]

BC67 The IASB took the view that these simplifications would not impede faithful representation because removing the business model assessment is unlikely to significantly affect how entities applying the Standard classify their financial assets because SMEs are unlikely to hold financial assets under different business models.

BC68 Feedback on the Request for Information and the SMEIG supported supplementing the list of examples in Section 11 with a principle for classifying financial assets based on their contractual cash flow characteristics. Many respondents said that it would provide helpful guidance if an asset does not match the characteristics described in the examples. The Request for Information did not ask a specific question about introducing the FVOCI election and the feedback did not indicate a demand for this election.

BC69 In the light of the feedback, the IASB is proposing an amendment to supplement the list of examples in paragraphs 11.9A–11.11 of the Standard with a principle based on the contractual cash flow characteristics of the debt instrument.

BC70 Feedback on the Request for Information also supported aligning the Standard with the 2017 Amendments to IFRS 9 *Prepayment Features with Negative Compensation*. Consequently, the IASB is proposing to clarify that a party may pay or receive reasonable compensation on early termination of a debt instrument and the requirements in paragraph 11.9 of the Standard for that debt instrument to be a basic financial instrument measured at amortised cost may still apply.

BC71 The IASB is also proposing to clarify that reassessing how a financial instrument is classified is only required when contractual terms are modified and result in the financial instrument being derecognised. Such a requirement is aligned with the requirements in IFRS 9, but is simplified for consistency with the derecognition requirements in Section 11 and the IASB's decision not to introduce requirements for SMEs to determine how financial assets should be classified on the basis of their business model.

Impairment of financial assets

BC72 The current requirements for recognising and measuring impairment of financial assets measured at cost or amortised cost in the Standard are based on IAS 39. The impairment model in IAS 39 and Section 11 (an incurred loss model) may delay an entity's recognition of credit losses because an impairment test is not required until there is objective evidence of impairment. The impairment requirements in IFRS 9 responded to the

6 IFRS 9 permits an entity to make an irrevocable election at initial recognition 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 (FVOCI election).

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problem of delayed recognition by requiring an entity to recognise expected credit losses.

BC73 In considering aligning the requirements for the impairment of financial assets in Section 11 with IFRS 9, the IASB noted that the scope of the Standard excludes any entity that holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. Banks, credit unions, insurance companies, securities brokers, securities dealers, mutual funds and investment banks often satisfy this criterion. Therefore, the general approach to impairment in IFRS 9 would not be relevant to many entities applying the Standard. However, the IASB observed that the expected credit loss model is widely regarded as an improvement on the approach in IAS 39 and so the IASB included a question in the Request for Information about introducing the simplified approach in IFRS 9 into the Standard.

BC74 Feedback on the Request for Information was varied. Some respondents agreed with alignment with the simplified approach in IFRS 9, but some also called for the simplified approach in IFRS 9 to be further simplified. Some respondents and some SMEIG members suggested that SMEs measure expected credit losses based on management's 'best estimate' of contractual cash flows less expected cash flows (best-estimate approach), instead of considering a weighted probability of a range of possible outcomes. Other respondents disagreed with alignment and expressed concerns that an expected credit loss model would be difficult for SMEs to apply and would impose undue cost or effort on them. Feedback from the user survey and user interviews did not show a demand for the more sophisticated information provided under an expected credit loss model for SMEs.

BC75 In response to the feedback and to the SMEIG's suggestion, the staff did further research by interviewing four global preparers about their experience of implementing and applying the expected credit loss model in IFRS 9. The aim of this research was to understand the practical challenge for entities that have implemented and now apply the simplified approach. Feedback from those interviews indicated that implementing the simplified approach in IFRS 9 would be complex for SMEs and would not result in significant changes in the amount of impairment for the types of financial assets held by typical SMEs, namely short-term trade receivables.

BC76 Some IASB members expressed concern about modifying the simplified approach in IFRS 9 for SMEs, for example, by introducing a best-estimate approach. Their concern was that such an approach may imply an outcome aligned with the expected credit loss model in IFRS 9, which may not necessarily be true. For example, some members raised concerns that an SME's best estimate might be interpreted as the most likely repayment outcome, meaning an SME could conclude that its best estimate of credit losses is nil. Such an interpretation would be inconsistent with the IFRS 9 expected credit loss model, which requires an entity to consider the possibility that a credit loss will occur even if the possibility is low. The IASB observed that the expected credit loss model in IFRS 9 contains several expedients and was designed to be proportionate for different types of entities, because the focus is on reasonable and supportable information that is available without undue cost or effort (see paragraph 5.5.17(c) of IFRS 9). Therefore, the IASB decided that if a forward-looking impairment model is proposed the Standard should be aligned with the simplified approach in IFRS 9, with further simplifications for SMEs if necessary, rather than introducing modifications to that model for SMEs. In considering whether to include an expected credit loss model into the Standard, the IASB observed that:

(a) the expected credit loss model in IFRS 9 was developed predominantly to respond to concerns, which were highlighted during the 2008 financial crisis, about delayed recognition of credit losses on loans. Financial institutions are generally outside the scope of the Standard. SMEs typically have no significant long-term loan receivables or investments in bonds. Many SMEs only hold short-term, non-interest-bearing financial assets, specifically trade receivables.

(b) feedback on the Request for Information and from interviews with preparers identified that SMEs already consider forward-looking information when assessing the impairment of trade receivables. Such information is considered because SMEs usually prepare less timely financial statements, meaning SMEs will capture events after the reporting period over a longer period. For many SMEs, by the time their financial statements are issued, most of the financial assets outstanding at the reporting date will have been settled.

(c) feedback also identified that many SMEs already apply a collective impairment approach using a provision matrix. This feedback highlighted that, for SMEs holding only trade receivables, moving to an expected credit loss model is likely to involve substantial implementation costs without a substantial change in impairment information or benefits for users of their financial statements.

BC77 The IASB concluded that the feedback provides evidence that:

(a) moving to an expected credit loss model would provide better information for users of financial statements when SMEs hold longer-term financial assets; but

(b) retaining an incurred loss model for impairment would be the approach best supported by cost–benefit considerations for SMEs that hold trade receivables, which are normally short-term, non-interest-bearing assets.

BC78 Therefore, the IASB is proposing to:

(a) retain the incurred loss model in Section 11 for trade receivables and contract assets in the scope of the revised Section 23 *Revenue from Contracts with Customers*.

(b) require an SME to use an expected credit loss model for all other financial assets measured at amortised cost, aligned with the simplified approach in IFRS 9.

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(c) retain the requirements in Section 11 for impairment of equity instruments measured at cost. IFRS 9 requires entities to measure all equity instruments at fair value, and so the expected credit loss model does not apply to equity instruments.

BC79 The IASB acknowledged that having two impairment models could add complexity to Section 11. However, it noted that only those SMEs that hold financial assets other than trade receivables and contract assets would be required to apply an expected credit loss model, preserving the simplicity of the Standard for those entities that hold only trade receivables and contract assets.

BC80 The IASB also observed that the proposed amendments would enable respondents to evaluate and comment on both the incurred loss model and the IASB's proposals for an expected credit loss model for SMEs. Feedback on the Exposure Draft will help the IASB evaluate the two approaches and decide how to proceed without needing to re-expose its proposals.

Hedge accounting

BC81 IFRS 9 introduced new requirements that resulted in a major overhaul of hedge accounting. Section 12 *Other Financial Instrument Issues* sets out requirements for the types of hedging transactions an SME is likely to use to manage risks and was greatly simplified from IAS 39 when the Standard was issued. In the Request for Information, the IASB asked for views on whether the Standard should provide hedge accounting requirements, and on retaining the current requirements or aligning them with IFRS 9.

BC82 Feedback on the Request for Information indicated that SMEs do not frequently apply hedge accounting. Some respondents noted that, even when SMEs undertake economic hedges, they do not apply hedge accounting because of its complexity. Nevertheless, respondents and the SMEIG generally agreed with continuing to include hedge accounting requirements in the Standard because removing these requirements would disadvantage entities that apply them.

BC83 However, there were mixed views on whether to retain the requirements unchanged or align them with IFRS 9:

(a) many respondents agreed with retaining the hedge accounting requirements unchanged because they are well understood and adequate for SMEs' typical hedging activities; and

(b) some respondents preferred that the hedge accounting requirements be aligned with IFRS 9, with or without simplifications, because IFRS 9 permits the use of hedge accounting in additional circumstances and would benefit SMEs with more sophisticated hedging transactions.

BC84 The IASB observed that the hedge accounting model in IFRS 9 introduces improvements principally by aligning the accounting more closely with an entity's risk management activities. The model in IFRS 9 enables:

(a) entities to better reflect their risk management activities in the financial statements and use information produced internally as a basis for hedge accounting; and

(b) investors to better understand the entity's risk management activities and the effect of its hedging on its financial statements.

BC85 The IASB's primary aim in developing and maintaining the Standard is to provide a stand-alone, simplified set of accounting principles for entities that do not have public accountability and that typically have less complex transactions, limited resources to apply full IFRS Accounting Standards and that operate in circumstances in which comparability with their listed peers is not an important consideration.[7] Feedback indicates that such entities are unlikely to have sophisticated risk management activities that involve hedging strategies. They are also likely to have simpler financial reporting needs and might choose not to apply hedge accounting even if they engage in basic hedging transactions.

BC86 Consistent with its primary aim, the IASB observed that improvements IFRS 9 introduced would generally not be relevant for the transactions undertaken by 'typical' SMEs (for example, reducing complexity from IAS 39 and improved reflection of risk management activities). Therefore, it noted that alignment with IFRS 9 would add complexity for all SMEs applying hedge accounting without substantial benefits for users of their financial statements to cater for entities applying the Standard that might have more sophisticated hedging activities.

BC87 Section 12 focuses on the types of risk that SMEs are likely to hedge, and the feedback provides evidence that the requirements are well understood and adequate for typical SMEs and users of their financial statements. Consequently, the IASB is proposing to retain the existing hedge accounting requirements.

Using recognition and measurement requirements in full IFRS Accounting Standards for financial instruments

BC88 The Standard permits entities to choose to apply either (see paragraph 11.2 of the Standard):

(a) the requirements in both Sections 11 and 12 in full; or

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

BC89 The Standard refers specifically to IAS 39 and provides no option to apply the recognition and measurement requirements in IFRS 9.

BC90 The option to apply the recognition and measurement requirements in IAS 39 is the only option to apply the requirements in full IFRS Accounting Standards (fallback to full IFRS Accounting Standards) included in the Standard. The IASB's main reason for permitting the fallback was that SMEs should be

7 See paragraph BC187 of the Basis for Conclusions on the Standard.

permitted to have the same accounting policy options as in IAS 39, pending completion of the IASB's comprehensive project to replace IAS 39 with IFRS 9.[8]

BC91 During the first comprehensive review of the Standard, the IASB noted that consistent with its primary aim of developing a stand-alone, simplified Standard (see paragraph BC85), it would prefer the only fallback to full IFRS Accounting Standards in the Standard to be removed. However, the IASB decided to retain the fallback pending consideration of IFRS 9 during a future review and further evidence of how frequently SMEs use the fallback.[9]

BC92 In the Request for Information, the IASB asked whether respondents are aware of entities that choose to apply the recognition and measurement requirements of IAS 39. It also asked for views on changing the reference to IAS 39 to permit an entity to apply the recognition and measurement requirements in IFRS 9 and the disclosure requirements in Sections 11 and 12 (that is, updating the fallback to IAS 39 to a fallback to IFRS 9).

BC93 The IASB observed that, while most respondents supported updating the fallback from IAS 39 to IFRS 9, most explained that they did so because IFRS 9 is an improved Standard or because the IASB plans to withdraw IAS 39. Furthermore, most respondents, including those that approved of updating the fallback, said they are not aware of SMEs applying it. Therefore, the IASB decided the feedback provided insufficient evidence for retaining the fallback to full IFRS Accounting Standards.

BC94 In the light of this feedback, the IASB is proposing to remove the option to apply the recognition and measurement requirements in full IFRS Accounting Standards for financial instruments in Sections 11 and 12. That is, the IASB is proposing to remove the fallback to IAS 39, without replacing it with a fallback to IFRS 9 because:

(a) the IASB has not identified a good reason for indefinitely maintaining a single exception in the Standard, which permits SMEs to use the recognition and measurement requirements of full IFRS Accounting Standards. The IASB intends the Standard to be a self-contained, stand-alone set of accounting principles. Therefore, any options or requirements considered appropriate should be incorporated in the Standard, not incorporated via a cross-reference to full IFRS Accounting Standards.

(b) the IASB aims to restrict accounting policy options in the Standard because including more complex options generally increases complexity and options also reduce comparability. Paragraphs BC208–BC209 of the Basis for Conclusions on the Standard explain the IASB's reasons for restricting accounting policy options.

8 Paragraph BC106 of the Basis for Conclusions on the Standard sets out the IASB's original reasoning for permitting the fallback to IAS 39.

9 Paragraph BC217 of the Basis for Conclusions on the Standard sets out the IASB's reasoning for retaining the fallback to IAS 39 during the first comprehensive review.

(c) feedback on the Request for Information identified that most respondents are unaware of entities opting to apply the fallback to IAS 39. Furthermore, during this second comprehensive review, the IASB is considering aligning Sections 11 and 12 with IFRS 9. Therefore, the reasons for retaining the fallback to IAS 39 as stated in paragraph BC91 are no longer applicable.

(d) feedback during the first comprehensive review was that most SMEs applied Sections 11 and 12 in full because applying the fallback would be onerous—except subsidiaries of a parent entity that prepares consolidated financial statements complying with full IFRS Accounting Standards.[10] In July 2021, the IASB published Exposure Draft ED/2021/7 *Subsidiaries without Public Accountability: Disclosures*, which would permit these subsidiaries to apply full IFRS Accounting Standards with a reduced set of disclosure requirements. These subsidiaries may find that the proposed new Standard *Subsidiaries without Public Accountability: Disclosures* will be more cost beneficial in their circumstances than applying the *IFRS for SMEs* Accounting Standard.

Issued financial guarantee contracts

BC95 In 2017, the SMEIG issued Q&A 2017/12.1 *Accounting for financial guarantee contracts in individual or separate financial statements of the issuer*. Q&A 2017/12.1 explains that an entity applies the requirements in Section 12 to issued financial guarantee contracts, unless the reporting entity applies the option to use the recognition and measurement requirements in IAS 39. An entity applying Section 12 measures an issued financial guarantee contract at fair value initially and at the end of each reporting period, with changes in fair value recognised in profit or loss.

BC96 In finalising Q&A 2017/12.1, the SMEIG noted that some respondents to the draft Q&A said the requirement for issued financial guarantee contracts to be measured at fair value at the end of each reporting period is more complex than the accounting requirements in IFRS 9. Therefore, the SMEIG recommended that the IASB revisit the accounting for issued financial guarantee contracts during the second comprehensive review, and provide measurement relief. Responding to this advice, in the Request for Information, the IASB asked for views on aligning the accounting requirements for issued financial guarantee contracts in Section 12 with IFRS 9.

BC97 In developing Q&A 2017/12.1, the SMEIG applied the definition of a 'financial guarantee contract' in IFRS 9 because the Standard includes no equivalent definition. Therefore, in the Request for Information, the IASB asked for views on introducing the IFRS 9 definition into the Standard for clarity. Respondents generally agreed with this suggestion. Therefore, the IASB is proposing an amendment to include the IFRS 9 definition of a 'financial guarantee contract' in the Standard.

10 See paragraph BC217(c) of the Basis for Conclusions on the Standard.

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BC98 Stakeholders had mixed views on aligning the requirements for issued financial guarantee contracts with IFRS 9. Some respondents raised concerns that the IFRS 9 requirements are too complex for SMEs and simplifications should be considered. Some respondents said entities should apply Section 21 *Provisions and Contingencies* to issued financial guarantee contracts because the requirements in Section 21 are simpler for SMEs than the requirements in IFRS 9. Some respondents noted that the type of financial guarantees commonly issued by SMEs are related party financial guarantees. However, the IASB noted that a financial guarantee contract meets the definition of a 'financial liability' and so should be accounted for as a financial instrument, not a provision.

BC99 An entity applying IFRS 9 initially measures an issued financial guarantee contract at fair value and thereafter at the higher of:

(a) the provision for expected credit losses; and

(b) the amount initially recognised less the cumulative amount of income recognised, when appropriate, applying the principles of IFRS 15 *Revenue from Contracts with Customers*.

BC100 To respond to feedback that the IFRS 9 requirements are too complex, the IASB is proposing these simplifications for SMEs:

(a) the contract would be initially measured at the premium received (plus the present value of any future premium payments receivable). This simplification would respond to feedback that determining the fair value of an issued financial guarantee contract is difficult, particularly for related party contracts. The simplification is also consistent with the requirement in paragraph 11.13 of the Standard that a basic financial asset or liability is initially measured at the transaction price unless the arrangement constitutes a financing transaction.

(b) the wording in paragraph BC99(b) would be simplified by referring to 'the amount initially recognised, if any, amortised on a straight-line basis over the life of the guarantee'. The IASB observed that usually the outcome of applying this wording would be similar to the outcome of applying paragraph BC99(b) for the types of financial guarantee contracts commonly issued by entities applying the Standard (although the amount initially recognised may not be fair value). Furthermore, this wording would be easy to apply and be understood by entities applying the Standard and users of their financial statements.

BC101 Some IASB members expressed concern about recognising the financial guarantee contract at the premium receivable because users of financial statements might lose useful fair value information. These IASB members observed that the premium might be nil for related party financial guarantee contracts, such as intragroup financial guarantee contracts. Some IASB members were also concerned that if the financial guarantee is recorded on initial recognition at nil, this would lead to the recognition of expected credit losses in the period in which the guarantee was issued. Nevertheless, the IASB observed that under the proposed requirements the liability would, at a minimum, at each reporting date be subsequently measured at the amount of the allowance for expected credit losses, which would provide useful information in the statement of financial position about the entity's exposure to credit risk.

BC102 Some IASB members expressed concerns about the cost of measuring expected credit losses for the financial guarantee contract at each reporting date. However, the IASB observed that this cost was a consequence of incorporating an expected credit loss model into the Standard. It also observed that there was no good reason to have a specific exception for financial guarantee contracts.

Requirements for financial instruments in relation to the interbank offered rate (IBOR) reform

BC103 A small number of respondents to the Request for Information suggested the IASB monitor the progress of IBOR reform and if necessary provide reliefs similar to those in full IFRS Accounting Standards. These respondents are referring to the effects of the interest rate benchmark reform on an entity's financial statements that arise when, for example, an interest rate benchmark used to calculate interest on a financial asset is replaced with an alternative benchmark rate. The IASB issued amendments to full IFRS Accounting Standards in 2019 and 2020 to provide relief from the effects of interest rate benchmark reform.

BC104 The IASB consulted the SMEIG and based on the advice of SMEIG members decided no action should be taken for the amendments to full IFRS Accounting Standards relating to the IBOR reform because:

(a) in many jurisdictions the IBOR reform is likely to be completed before any amendments to the Standard from the second comprehensive review are issued. These timings mean any reliefs are unlikely to be helpful for SMEs.

(b) the amendments to full IFRS Accounting Standards assist entities in addressing issues that might affect financial reporting during the reform—issues such as the effects of changes to contractual cash flows arising from the replacement of an interest rate benchmark with an alternative benchmark. The Standard does not include detailed requirements for contract modifications. Therefore, introducing these amendments could lead to unnecessary complexity.

Financial instruments that form part of the long-term investment in an associate or jointly controlled entity

BC105 Feedback on the Request for Information supported aligning the Standard with the 2017 Amendments to IAS 28 *Long-term Interests in Associates and Joint Ventures* (see Table A1 accompanying this Basis for Conclusions). In view of this feedback and the IASB's proposed amendments to the impairment model in Section 11, the IASB is also proposing to clarify application of Section 11 and Section 14 *Investments in Associates* when an entity applies the equity method in Section 14 and has financial instruments that form part of the entity's net investment in an associate or jointly controlled entity.

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Single section on financial instruments

BC106 The IASB is proposing to consolidate the fair value measurement requirements in a new section (see paragraphs BC116–BC118). The proposal is to combine Sections 11 and 12 into a single section renamed Section 11 *Financial Instruments* to enable the fair value measurement requirements to be included in Section 12 *Fair Value Measurement*. The IASB is proposing the previous requirements in Section 11 are included as Part I of the revised Section 11 and the previous requirements in Section 12 are included as Part II of the revised Section 11.

Other financial instruments topics

BC107 In the Request for Information, the IASB decided not to specifically ask for views on aligning Sections 11 and 12 with IFRS 9 in respect of financial liabilities and own credit risk, and derecognition. Feedback on the Request for Information provided no evidence that the IASB should consider amendments for these topics:

(a) *financial liabilities and own credit risk*—the IASB assessed that the issue of own credit risk is unlikely to be relevant to entities applying the Standard. The IASB decided it was unnecessary to seek views on financial liabilities and own credit risk.

(b) *derecognition*—the requirements for derecognising financial assets and financial liabilities were carried forward from IAS 39 to IFRS 9 and the principle for derecognition is already simplified in Sections 11 and 12. Therefore, the IASB decided it was unnecessary to seek views on derecognition.

(New) Section 12 *Fair Value Measurement*

BC108 Paragraphs 11.27–11.32 of the Standard set out requirements for measuring fair value and are referred to in other sections of the Standard that require or permit the use of fair value. Examples include Sections 14 and 15 (the fair value model for associates and jointly controlled entities), Section 16 (investment property) and Section 28 (the fair value of pension plan assets).

BC109 In May 2011, the IASB issued IFRS 13 *Fair Value Measurement*. IFRS 13 is a single source of fair value measurement guidance that clarifies the definition of 'fair value', provides a clear framework for measuring fair value and enhances disclosures about fair value measurements.

Definition of fair value and fair value guidance

BC110 In the first comprehensive review of the Standard, the IASB consulted with stakeholders on aligning the definition of 'fair value' and the guidance on measuring fair value in the Standard with IFRS 13, but decided not to align, because IFRS 13 had only recently become effective.

BC111 In December 2018, the IASB completed its Post-implementation Review of IFRS 13 and concluded that IFRS 13 is working as intended. The IASB observed that the Post-implementation Review of IFRS 13 provided evidence it should align the Standard with IFRS 13 by applying the IASB's alignment principles.

BC112 In applying the alignment principles, the IASB assessed that alignment with IFRS 13 is relevant to SMEs because it would lead to greater clarity and consistency when SMEs are permitted or required to use a fair value measurement, thereby improving the information provided to users of SMEs' financial statements. Consequently, in the Request for Information, the IASB asked for views on:

(a) aligning the definition of fair value with IFRS 13;

(b) aligning the guidance on fair value measurement with the principles of the fair value hierarchy set out in IFRS 13; and

(c) including examples that illustrate how to apply the hierarchy.

BC113 Respondents to the Request for Information and the SMEIG favoured aligning the Standard with the definition of 'fair value' in IFRS 13 to provide clarity and enhance comparability between financial statements prepared applying the Standard.

BC114 In applying its simplicity principle, the IASB observed that the IFRS 13 definition of 'fair value' is clearer and more comprehensive than the definition of 'fair value' in the Standard and it would, therefore, be simpler to apply. The IASB decided it was unnecessary to simplify the definition in IFRS 13 and is proposing to include that definition in the Standard.

BC115 Feedback on the Request for Information and the SMEIG also favoured aligning the Standard with the guidance on measuring fair value in IFRS 13 and including examples to illustrate how to apply the fair value hierarchy set out in IFRS 13. Some respondents suggested that introducing the IFRS 13 fair value hierarchy into the Standard would be clearer than the current approach, which is based on examples. The IASB agreed with these views and is proposing to align the Standard with the guidance on measuring fair value in IFRS 13. The IASB also agreed to include examples relevant to entities that apply the Standard illustrating how to apply the hierarchy.

Single section

BC116 In the Request for Information, the IASB asked for views on moving the guidance and related disclosure requirements from Section 11 to Section 2 to place these requirements alongside other pervasive principles and emphasise the relevance of these requirements across the Standard.

BC117 Many respondents to the Request for Information and most SMEIG members agreed with moving the requirements for measuring fair value and the disclosure requirements on fair value to Section 2. However, some respondents and some SMEIG members said it may not be appropriate to include the requirements for measuring fair value and disclosure requirements alongside the concepts and principles in Section 2. Many of

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these respondents suggested it would be more appropriate to have a new, separate section in the Standard.

BC118 The IASB agreed that a new section would emphasise the relevance of the fair value requirements across the Standard, while making it distinct from the concepts and principles in Section 2. Therefore, the IASB is proposing that the requirements for measuring fair value and related disclosure requirements be consolidated in a new section—Section 12 *Fair Value Measurement*. The IASB is proposing the previous requirements in Section 12 be included as Part II of the revised Section 11 *Financial Instruments*.

Section 15 *Investments in Joint Ventures* (renamed *Joint Arrangements*)

BC119 In the first comprehensive review of the Standard, the IASB consulted with stakeholders on aligning the requirements for joint arrangements in Section 15 *Investments in Joint Ventures* (proposed to be renamed Joint Arrangements) with IFRS 11, but decided not to align, because IFRS 11 *Joint Arrangements* had only recently become effective.

BC120 Section 15 of the Standard is based on IAS 31 *Interests in Joint Ventures*. In May 2011, the IASB issued IFRS 11, which replaced IAS 31. In Section 15, 'joint control' is defined as the 'contractually agreed sharing of control over an economic activity and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control'. In contrast, in IFRS 11, joint control is defined as the 'contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control'. The IASB noted that, when developing IFRS 11, it did not reconsider the concept of joint control but aligned the definition of 'joint control' with the definition of 'control' in IFRS 10.

BC121 An entity applying IFRS 11 classifies joint arrangements based on the parties' rights and obligations arising from the arrangements. IFRS 11 classifies joint arrangements as either joint operations or joint ventures. In contrast, IAS 31 and Section 15 classify joint arrangements based on the legal form of the arrangements—subdividing arrangements into three categories: jointly controlled operations, jointly controlled assets and jointly controlled entities. Unlike IAS 31, Section 15 does not permit an entity to apply proportionate consolidation in accounting for its interests in jointly controlled entities.

BC122 The IASB had received feedback (when the Request for Information was developed) that IFRS 11 had been challenging for some entities to apply—specifically classifying a joint arrangement as either a joint operation or a joint venture. Therefore, in the Request for Information, the IASB asked for views on aligning the definition of 'joint control' in Section 15 with the definition in IFRS 11, but retaining the three categories of joint arrangements in Section 15.

Aligning the definition of joint control

BC123 Most respondents favoured aligning the definition of joint control in Section 15 with that in IFRS 11. The IASB views aligning the definition of 'joint control' as a consequence of aligning the definition of 'control' in Section 9.

Classification and measurement requirements of joint arrangements

BC124 The IASB, in applying its alignment principles, noted that alignment of the classification and measurement requirements of joint arrangements is relevant to entities that apply the Standard because the improvements IFRS 11 introduced apply to entities that are parties to joint arrangements.

BC125 IFRS 11 requires an entity to exercise judgement to classify its interests in joint arrangements by assessing its rights and obligations arising from the arrangements. In some cases, the judgement required can be significant. There were mixed views from respondents on whether to align the classification requirements with IFRS 11 or retain the Section 15 classification requirements. Those respondents that preferred to retain the classification requirements in Section 15 said retaining the requirements would reduce judgement involved in classifying joint arrangements. However, some respondents said that retaining the classification requirements would embed an inconsistency with full IFRS Accounting Standards and could confuse users of SMEs' financial statements, especially those familiar with full IFRS Accounting Standards. However, the IASB concluded that retaining the classification requirements in Section 15 would be more consistent with the simplicity principle and there was sufficient evidence from the feedback on the Request for Information to retain the classification requirements.

BC126 Findings in the Post-implementation Review of IFRS 11 provided evidence that the requirements in IFRS 11 enable an entity to faithfully represent its interests in joint arrangements by reflecting its rights and obligations arising from the arrangements. However, the IASB concluded that retaining the classification requirements in Section 15 would not significantly impede faithful representation, because the accounting outcome for jointly controlled assets and jointly controlled operations reached by applying Section 15 is similar to the accounting outcome for joint operations reached by applying IFRS 11.

BC127 Section 15 includes an accounting policy election permitting an entity to choose to apply the cost model, the equity method or the fair value model to account for its jointly controlled entities. The IASB introduced the accounting policy election because entities that apply the Standard had experienced difficulty in applying the equity method and because fair values are relevant for lenders. Respondents to the Request for Information agreed with retaining the accounting policy election and the IASB agreed doing so was an appropriate application of the simplicity principle and cost–benefit considerations.

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A party to a jointly controlled operation or a jointly controlled asset (without joint control)

BC128 The IASB is proposing amendments to Section 15 to align it with the requirements in paragraph 23 of IFRS 11, so a party to a jointly controlled operation or a jointly controlled asset that does not have joint control of those arrangements would account for its interest according to the classification of that jointly controlled operation or the jointly controlled asset.

BC129 If the IASB retained paragraph 15.18 of the Standard, a party to a jointly controlled operation or a jointly controlled asset that does not have joint control would recognise either a financial asset or an investment in an associate even though that party may have rights to the assets and obligations for the liabilities. The IASB expects that aligning Section 15 with paragraph 23 of IFRS 11 for entities that are parties to a jointly controlled operation or a jointly controlled asset would result in an accounting outcome that faithfully represents the party's rights and obligations arising from the arrangement.

Section 19 *Business Combinations and Goodwill*

BC130 Section 19 is based on IFRS 3 (2004) *Business Combinations*, which requires an entity to apply the purchase method to business combinations.

BC131 In January 2008, the IASB issued a revised IFRS 3, which requires an entity to apply the acquisition method of accounting to business combinations. IFRS 3 (2008) enhances the relevance, reliability and comparability of information provided about business combinations and their effects. It was developed to address known deficiencies in IFRS 3 (2004) requirements and reduce application problems.

BC132 In October 2018, the IASB issued Amendments to IFRS 3 *Definition of a Business* following a Post-implementation Review of IFRS 3, to make it easier for entities to decide whether activities and assets they acquire are a business or a group of assets.

BC133 In May 2020, the IASB issued Amendments to IFRS 3 *Reference to the Conceptual Framework* following completion of the IASB's research on the possible consequences of referring to the revised definitions of an asset and of a liability.

BC134 During the first comprehensive review of the Standard, the IASB decided against amending the Standard to include the changes introduced by IFRS 3 (2008) because the requirements in Section 19 were working well in practice and requiring more assets to be measured at fair value would introduce complexity. The IASB also prioritised providing SMEs with a stable platform over aligning the Standard with full IFRS Accounting Standards.

BC135 In reassessing the alignment of Section 19 with IFRS 3 (2008) as part of this second comprehensive review, the IASB considered:

(a) the completed Post-implementation Review of IFRS 3 (2008) and the amendment of the definition of a 'business' following the Post-implementation Review;

(b) the increased implementation experience of IFRS 3 (2008), which entities have been applying for several years; and

(c) the increased familiarity of entities with applying Section 19 (which was based on IFRS 3 (2004)).

2018 definition of a 'business'

BC136 In the Request for Information, the IASB asked for views on aligning the definition of a 'business' in the Standard with the amended definition of a business issued in 2018.

BC137 In applying the alignment principles, the IASB assessed that aligning the definition of a 'business' in the Standard with the amended definition of a 'business' issued in 2018 is relevant to SMEs. The improvements introduced in the 2018 definition would enhance the consistency of application and provide clarity and understandability for users of SMEs' financial statements and, therefore, would make a difference in the decisions of those users.

BC138 Feedback on the Request for Information supported aligning the definition of a 'business' in the Standard with the 2018 definition of a 'business' because it would provide clarity and understandability for users of financial statements, and consistency and comparability between the financial statements of entities applying the Standard would be improved. The IASB agreed with respondents that the definition of a 'business' is important because accounting for the acquisition of a set of activities and assets depends on whether the set is a business or merely a group of assets.

BC139 In applying its simplicity principle, the IASB observed that the 2018 definition of a 'business' is clearer than the current definition in the Standard and is simpler for preparers to apply. Therefore, the IASB decided it was unnecessary to further simplify the 2018 definition of a 'business'.

BC140 Therefore, the IASB is proposing to align the definition of a 'business' in the Standard with the amended definition of a 'business' issued in 2018. Some respondents suggested that the IASB include application guidance to assist entities applying the requirements of the 2018 definition of a 'business'. The IASB agreed and is proposing to add application guidance in a new appendix to Section 19 that includes:

(a) the optional concentration test in paragraphs B7A–B7B of IFRS 3;

(b) a decision tree to assess whether an acquired process is substantive; and

(c) the application guidance for the assessment in paragraphs B8–B12D of IFRS 3, along with some illustrative examples.

BC141 As a possible simplification, the IASB also considered introducing a rebuttable presumption in Section 19 when an entity applies the definition of a 'business' —so that if an acquired set of activities and assets has outputs, the rebuttable presumption is that the set of activities and assets qualifies as a business at the acquisition date. This presumption could be rebutted using the factors set out in paragraphs B12B–B12C of IFRS 3.

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BC142 The IASB sought the SMEIG's views. Many SMEIG members advised the IASB against introducing the rebuttable presumption because, for example, applying such a presumption could lead to inappropriate conclusions in several situations and would be inconsistent with the 'minimum requirements to be a business' as set out in paragraph B8 of IFRS 3, impeding faithful representation and damaging the quality of information reported to users. Some SMEIG members said the IASB should introduce the rebuttable presumption.

BC143 The IASB agreed with those SMEIG members who did not favour introducing the rebuttable presumption.

The acquisition method of accounting

Simplifications to the acquisition method of accounting

BC144 The Request for Information explained the IASB was not asking for views on amending the Standard:

(a) to change the recognition criteria for recognising an intangible asset acquired in a business combination;

(b) to clarify that an assembled workforce is not recognised as an intangible asset;

(c) to provide additional guidance on reacquired rights; and

(d) to introduce the option to measure non-controlling interests at fair value.

BC145 The IASB acknowledged that not aligning Section 19 with these requirements in IFRS 3 would result in the requirements for accounting for business combinations in the Standard diverging from the acquisition method of accounting. However, the topics the IASB had sought views on (see paragraphs BC165–BC183) aimed to balance simplicity and faithful representation. The IASB reasoned that, applying the Standard, goodwill acquired in a business combination is amortised over its useful life. Consequently, intangible assets acquired in a business combination that are not recognised separately are amortised through the annual amortisation of goodwill. Therefore, the allocation of items between intangible assets and goodwill has less of an effect on financial statements prepared applying the Standard than it does on financial statements prepared applying IFRS 3. The IASB also decided these requirements would introduce unnecessary complexity into the Standard.

1—Identifying the acquirer

BC146 Paragraph B18 of IFRS 3 requires that a new entity formed to effect a business combination is not necessarily the acquirer. Section 19 has no equivalent requirement.

BC147 In responding to the Request for Information, a few respondents and a few SMEIG members suggested that the IASB introduce the guidance in paragraph B18 of IFRS 3 into Section 19. In their view the guidance would:

(a) be useful to preparers and users of financial statements prepared applying the Standard because these types of business combinations are pervasive among entities that apply the Standard, particularly in group reorganisations; and

(b) fill a gap in the Standard.

BC148 In applying its relevance principle, the IASB observed that the feedback on the Request for Information provided evidence that the topic is relevant.

BC149 In applying its simplicity and faithful representation principles, the IASB noted that entities that apply the Standard are already familiar with the indicators set out in paragraph 19.10 of the Standard for identifying an acquirer in situations in which it may be difficult to identify an acquirer. The IASB observed that introducing such guidance would enhance comparability, reduce diversity and provide useful information when a new entity is formed to effect a business combination (that is, if the new entity issues equity shares to effect the business combination).

BC150 Therefore, the IASB is proposing to introduce guidance for a new entity formed to effect a business combination in the new appendix to Section 19, as set out in paragraphs B13–B18 of IFRS 3.

2—Recognition and measurement principles (including exceptions to the principles)

BC151 Section 19 is based on IFRS 3 (2004) and includes the principle that an acquirer recognises separately, at the acquisition date, the acquiree's identifiable assets and liabilities that can be measured reliably and for which it is probable that any associated future economic benefits will flow to, or resources embodying economic benefits will flow from, the acquirer. IFRS 3, as amended in May 2020 (see paragraph BC133), requires recognition of identifiable assets acquired and liabilities assumed that meet the definitions of assets and liabilities in the 2018 *Conceptual Framework*.

BC152 The IASB observed that not aligning Section 19 with IFRS 3, as amended in May 2020, would be inconsistent with the proposed definitions of assets and liabilities in the revised Section 2, which the IASB is proposing to align with the 2018 *Conceptual Framework*.

BC153 The IASB decided to align Section 19 with IFRS 3, as amended in May 2020, so that, to qualify for recognition, the identifiable assets acquired and liabilities assumed would be required to meet the definitions of an asset and a liability in the revised Section 2 at the acquisition date.

BC154 The IASB also observed that in accordance with paragraph 19.15(d) of the Standard, SMEs recognise contingent liabilities assumed in a business combination, whether they are possible obligations or present obligations, when their fair value can be measured reliably. IFRS 3 requires entities to recognise contingent liabilities only if they are present obligations arising from past events whose fair value can be measured reliably.

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BC155 The IASB is proposing to clarify that an acquirer does not recognise a contingent liability assumed in a business combination that is not a liability. The proposed clarification would require an SME to recognise contingent liabilities assumed in a business combination only if it is a present obligation and would prohibit an SME from recognising 'possible obligations'.

BC156 The IASB noted that this clarification:

(a) would improve the financial information provided;

(b) would remove the efforts needed to measure the 'possible obligations' at fair value (removing an unnecessary complexity from the Standard); and

(c) would result in the recognition of an amount of goodwill that more faithfully represents the underlying economics of the business combination (avoiding any potential overstatement of the amount of goodwill recognised).

3—Guidance on reacquired rights

BC157 Paragraphs B36 and B53 of IFRS 3 provide guidance on reacquired rights.

BC158 In assessing if guidance on reacquired rights is relevant to SMEs, the IASB asked SMEIG members for their views. SMEIG members said reacquired rights occur infrequently for entities applying the Standard. Therefore, the IASB decided that this topic does not meet the relevance principle. Therefore, in the Exposure Draft, the IASB is not proposing to introduce additional guidance on reacquired rights.

4—Exceptions to the acquisition method (measuring non-controlling interests)

BC159 Section 19 requires that, at the acquisition date, an acquirer measures any non-controlling interest in the acquiree at the non-controlling interest's proportionate share in the recognised amounts of the acquiree's identifiable net assets. IFRS 3 permits the acquirer to measure it at either fair value or the non-controlling interest's proportionate share in the recognised amounts of the acquiree's identifiable net assets.

BC160 In the Request for Information, the IASB did not ask for views on aligning the Standard with IFRS 3 by introducing the option of measuring non-controlling interests at fair value (see paragraph BC144). The IASB was of the view that introducing such an option would add complexity into the Standard, particularly when the acquiree's shares are not traded in an active market. However, some feedback on the Request for Information questioned the elimination of this option.

BC161 In considering the feedback on the Request for Information, the IASB took the view that, conceptually, a non-controlling interest in the acquiree is a component of a business combination and, like other components, should be measured at fair value. Furthermore, the IASB observed that this view is consistent with the reporting entity concept and its proposal to revise Section 2.

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BC162 In reviewing the feedback, some IASB members retained the view that introducing the option would add complexity into the Standard. Other IASB members favoured introducing the option to measure non-controlling interests at fair value—both to align with IFRS 3 and because it would be more consistent with the way other components of a business combination are measured and would be useful in decision making.

BC163 The IASB observed that measuring non-controlling interests at the proportionate share of the acquiree's identifiable net assets recognises only the parent's share of goodwill (not the full goodwill). Accordingly, such measurement could be viewed as inconsistent with the revised Section 2. However, the IASB noted that:

(a) this treatment is optional in IFRS 3 and effectively represents an exception to the measurement principle in IFRS 3;

(b) not introducing the option is a simplification and the cost of measuring non-controlling interests at fair value may outweigh the benefit for SMEs; and

(c) the measurement principle in Section 19 requires recognition in full of the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values (except for retaining the simplified criteria for recognising intangible assets acquired in a business combination, see paragraph BC144) and that principle is consistent with the reporting entity perspective discussed in the revised Section 2.

BC164 The IASB is proposing to retain the requirement in Section 19 that an acquirer measures any non-controlling interest in the acquiree at the non-controlling interest's proportionate share in the recognised amounts of the acquiree's identifiable net assets. However, because IASB members have differing views, the IASB, in the Invitation to Comment on the Exposure Draft, asks a question about not introducing the option to measure non-controlling interests at fair value.

5—Contingent consideration

BC165 Section 19 requires that contingent consideration is included in the cost of the business combination at the acquisition date if its payment is probable and can be reliably measured. A change in the estimate of contingent consideration is treated as additional consideration and the cost of the business combination is adjusted—amending the amount of goodwill.

BC166 In the Request for Information, the IASB explained the benefit of requiring an SME to recognise contingent consideration at fair value and subsequently measure it at fair value at each reporting date, with changes in fair value recognised in profit or loss. This requirement would improve users' ability to understand the cost of the business combination and result in the amount of goodwill recognised being a more faithful representation of the underlying economics of the business combination. Therefore, the requirement is relevant to entities applying the Standard.

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BC167 In the Request for Information, the IASB asked for views on aligning Section 19 with the requirements for contingent consideration set out in IFRS 3. The IASB also asked for views on simplifying these requirements by permitting an SME to use the undue cost or effort concept in the Standard, including the related disclosures, if measuring contingent consideration at fair value would involve undue cost or effort.

BC168 Respondents to the Request for Information supported aligning Section 19 with the requirements for contingent consideration set out in IFRS 3 (and permitting an SME to use the undue cost or effort concept) because it would more faithfully represent the underlying economics of a business combination. This alignment would also enhance comparability and provide better-quality information to users of SMEs' financial statements.

BC169 A few respondents to the Request for Information expressed concern that requiring contingent consideration to be measured at fair value could introduce complexity. These respondents were also concerned about the risk that SMEs might apply the undue cost or effort concept like an accounting policy choice (that is, an SME might choose to disclose information about contingent consideration instead of attempting to estimate the fair value of that consideration).

BC170 In applying its simplicity and faithful representation principles, the IASB acknowledged that requiring an SME to recognise the contingent consideration at fair value would extend the use of fair value in the Standard. At the same time, delaying the recognition of the contingent consideration would fail to consider that the acquirer's agreement to make contingent payments is the obligating event in a business combination. Therefore, delaying the recognition of the contingent consideration would not faithfully represent the economic consideration exchanged at that date.

BC171 To balance simplicity and faithful representation:

(a) the IASB is proposing to align Section 19 with the requirements for contingent consideration in IFRS 3 and, therefore, to require an SME to recognise contingent consideration at fair value and subsequently measure it at fair value at each reporting date, with changes in fair value recognised in profit or loss.

(b) the IASB is also proposing to exempt an entity from measuring contingent consideration at fair value if that would involve undue cost or effort. An entity applying the exemption would recognise an estimate of the most likely amount of contingent consideration and subsequently review the estimate at each reporting date to reflect the current estimate of the most likely amount. Any adjustments to the amounts previously recognised would be recognised in profit or loss. The IASB views its proposals as consistent with its conclusion, set out in paragraph BC357 of the Basis for Conclusions on IFRS 3, that those subsequent changes in value are generally directly related to post-combination events and changes in circumstances related to the combined entity. Thus, these adjustments should not affect the measurement of the consideration transferred or goodwill on the acquisition date.

6—Business combination achieved in stages (step acquisition)

BC172 Section 19 does not include requirements for step acquisitions. IFRS 3 requires an acquirer to:

(a) measure the fair value of assets and liabilities acquired at the acquisition date and determine the amount of goodwill at the acquisition date; and

(b) remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss in profit or loss.

BC173 The IASB assessed that introducing the requirements set out in IFRS 3 for step acquisitions would improve comparability and provide better-quality information to users. In the absence of requirements in the Standard, SMEs may apply other practices.

BC174 Therefore, the IASB asked for views—first, on whether requirements for step acquisitions should be introduced into Section 19 and, second, on whether those requirements should be aligned with IFRS 3.

BC175 Respondents to the Request for Information agreed with introducing requirements for the accounting for step acquisitions as set out in IFRS 3 because, for example:

(a) the topic is relevant for SMEs.

(b) applying IFRS 3 requirements for step acquisitions would enhance comparability and provide useful information about business combinations and reduce diversity in accounting. It would also require that the fair values of the consideration given, and net assets acquired, are measured on a consistent basis.

BC176 However, there was mixed feedback from SMEIG members on whether entities applying the Standard undertake step acquisitions and, therefore, whether the relevance principle was met.

BC177 In applying its relevance principle, the IASB observed that the feedback on the Request for Information provides evidence that including requirements for step acquisitions aligned with IFRS 3 satisfies the relevance principle. However, the IASB noted that SMEIG members had mixed views on this matter. Thus, the IASB is proposing to include requirements for step acquisitions but asking for further information on introducing these requirements in the Invitation to Comment on the Exposure Draft.

7—Acquisition-related costs

BC178 Section 19 requires costs directly attributable to the business combination to be added to the cost of the business combination.

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BC179 In the Request for Information, the IASB noted that introducing requirements for SMEs to recognise acquisition-related costs as an expense at the time of the acquisition (as set out in IFRS 3) would result in the amount of goodwill recognised more faithfully representing the underlying economics of the business combination. Therefore, the requirements would be relevant to SMEs and improve users' ability to understand the cost of the business combination.

BC180 In the Request for Information, the IASB asked for views on aligning Section 19 with the requirements for acquisition-related costs set out in IFRS 3.

BC181 Feedback on the Request for Information supported recognising acquisition-related costs separately as an expense because these costs are not considered part of the fair value exchange between the buyer and seller of the business combination.

BC182 In applying its simplicity and faithful representation principles, the IASB observed that recognising acquisition-related costs as an expense at the time of the acquisition would:

(a) introduce a simplification into the Standard; and

(b) result in the amount of goodwill recognised more faithfully representing the underlying economics of the business combination.

BC183 Therefore, IASB is proposing to align Section 19 with the requirements for acquisition-related costs in IFRS 3, by requiring an SME to recognise acquisition-related costs as an expense at the time of the acquisition.

Section 23 *Revenue* (renamed *Revenue from Contracts with Customers*)

BC184 Section 23 *Revenue* is based on IAS 11 *Construction Contracts* and IAS 18 *Revenue*. This section requires revenue to be recognised for goods when risks and rewards are transferred and, for services, as the service is performed.

BC185 In 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*, which replaced IAS 11 and IAS 18. IFRS 15 was developed to eliminate the inconsistencies and weaknesses in previous revenue Standards. IFRS 15 introduced a single framework for recognising revenue for both goods and services, which requires revenue to be recognised when the customer obtains control of the good or service.

BC186 In the Request for Information, the IASB acknowledged the importance of revenue to financial statements and the potential negative effects of not aligning Section 23 with IFRS 15. However, the IASB also noted that, if Section 23 were aligned with IFRS 15, many entities applying the Standard could see limited changes in the amount and timing of revenue recognised.

BC187 Therefore, in the Request for Information, the IASB asked for views on alternative approaches to aligning Section 23 with IFRS 15, which included:

(a) modifying Section 23 only to remove the clear differences in outcome from applying Section 23 or IFRS 15, without wholly reworking Section 23; and

(b) fully rewriting Section 23 to reflect the principles and language used in IFRS 15.

BC188 Respondents to the Request for Information and the SMEIG generally agreed with aligning Section 23 with IFRS 15. However, respondents had mixed views on whether to modify or fully rewrite (revise) Section 23 (see paragraph BC187). SMEIG members supported aligning Section 23 with IFRS 15 by fully rewriting Section 23.

BC189 The IASB is proposing aligning Section 23 with IFRS 15 by fully rewriting Section 23 to reflect the principles and language used in IFRS 15. The IASB concluded that alignment with IFRS 15 would benefit users and preparers by:

(a) providing consistent and comparable information that more faithfully represents an entity's performance; and

(b) addressing the inconsistencies and weaknesses in the current Section 23 by providing a single, comprehensive framework for revenue recognition.

BC190 The IASB rejected the alternative of modifying Section 23 only to remove the clear differences in outcome from applying Section 23 or IFRS 15. In the IASB's view, that alternative approach would result in a hybrid model for revenue recognition that would be complex to apply. The alternative would also require two conceptually different frameworks for revenue recognition to be brought together, which could result in potential inconsistencies between the requirements. Therefore, the IASB concluded that fully rewriting Section 23 provides a straightforward approach to ensure the fundamental principles for revenue recognition in IFRS 15 are reflected in the Standard. Therefore, the IASB is proposing to revise Section 23 and to rename the section as Section 23 *Revenue from Contracts with Customers*.

BC191 The IASB is proposing simplifications to the requirements in IFRS 15 to reduce the costs of applying the revised Section 23:

(a) the term 'performance obligation' is used in IFRS 15 to identify the unit of account for goods and services promised in a contract with a customer. The IASB is proposing that the term 'promise' is used instead, which is more reflective of the language SMEs use to describe their obligations under contracts with customers.

(b) the definition of a 'performance obligation' in IFRS 15 specifies circumstances in which a promise to provide a series of goods or services is accounted for as a single performance obligation. To simplify the definition of a 'promise', the IASB is proposing to remove this specification from the definition and include it as a separate requirement in Section 23.

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(c) IFRS 15 requires contract modifications to be accounted for prospectively using one of two approaches each specified by criteria based on the type of modification (either treated as a separate contract or as a termination of the existing contract and the creation of a new contract). The IASB is proposing that the requirement to account for the modification as a separate contract is available to SMEs as an option when the specified criteria are met, rather than a requirement. This proposal simplifies the accounting for contract modifications by reducing the number of approaches and criteria that an SME is required to consider.

(d) if a contract includes a warranty and the customer does not have the option to purchase the warranty separately, IFRS 15 requires an entity to assess whether the warranty provides a service in addition to the assurance that the product complies with agreed-upon specifications. To limit the situations in which an SME is required to make this assessment, the IASB is proposing to require an SME to make this assessment only when the warranty is significant to the contract.

(e) IFRS 15 requires options granted to customers to purchase additional goods or services to be accounted for as separate performance obligations if these provide the customer with a material right. The IASB is proposing that SMEs separately account for material rights arising from a contract only when the effects of doing so are significant to the contract. This proposal is intended to limit situations when an SME is required to separately account for material rights.

(f) the IASB is proposing to simplify the expression of the requirements for constraining estimates of variable consideration in IFRS 15. The IASB is proposing to reframe the constraint on estimates of variable consideration in the positive by focusing on consideration that will become due instead of revenue reversals that will not occur. This proposal is intended to make the constraint more understandable for SMEs while retaining the level of confidence (highly probable) used in IFRS 15.

(g) IFRS 15 includes a principle that an entity applies to determine whether it is acting as a principal or agent, which is supported by three indicators. The IASB is proposing to reframe the principle and one indicator as circumstances that would result in an entity acting as a principal. If these circumstances are not met, the SME is acting as an agent. The IASB observed that the omitted indicators may be relevant to assessing whether an SME is acting as a principal. However, restricting the assessment to a limited number of factors makes the assessment more prescriptive, which is intended to make determining whether an entity is acting as a principal or an agent simpler for SMEs.

(h) the IASB is proposing that SMEs be required to adjust the promised amount of consideration for the time value of money if payment from customers is deferred beyond normal business terms. This proposal is less onerous than the requirement in IFRS 15 for an entity to adjust the promised amount of consideration for the time value of money if a contract contains any significant financing component, whether from deferred or advance payments.

(i) IFRS 15 includes criteria that specify circumstances in which an entity is required to allocate a discount or variable consideration entirely to one or more, but not all, performance obligations in a contract. Only in these circumstances is the entity allowed to depart from the default method of allocating the transaction price on a stand-alone selling price basis. The IASB is proposing to allow an SME to allocate a discount or variable consideration to promises using an alternative method if the default method does not depict the amount of consideration to which the SME expects to be entitled in exchange for transferring the goods or services. This proposal simplifies the process of allocating a discount or variable consideration to the promises in a contract by removing the requirement for an SME to consider criteria to depart from applying the default method, while still requiring the SME to apply a method that faithfully represents the consideration to which the SME is entitled.

(j) IFRS 15 specifies criteria that determine whether a licence of intellectual property transfers to a customer at a point in time or over time. The criteria require an entity to assess the effect of its activities on the intellectual property and can require an entity to assess whether the intellectual property has 'significant stand-alone functionality'. The IASB is proposing to require SMEs to determine whether a licence of intellectual property transfers at a point in time or over time by applying a single set of simplified criteria to assess the effect of the entity's activities on the benefit that a customer obtains from the intellectual property. The IASB's view is that this approach will result in an outcome consistent with IFRS 15 and so provide useful information for users of SMEs' financial statements, while being more intuitive and easier for SMEs to apply.

(k) IFRS 15 requires an entity to recognise the incremental costs of obtaining a contract as an asset if the entity expects to recover those costs. The IASB is proposing that these costs are recognised as an asset if an SME can identify and assess the costs as recoverable without undue cost or effort. The undue cost or effort exemption is intended for SMEs operating in industries in which the costs of obtaining a contract relative to the costs of fulfilling the contract are small and not reflected in management's assessment of a contract's profit margin or a contract's pricing. In such circumstances, the costs of recognising an asset may exceed the benefits of the information for users of the financial statements.

(l) to simplify application of the proposed revenue recognition model, the revised requirements in Section 23 are structured based on the five steps of this model and reflect the order in which SMEs are expected to apply them.

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BC192 As well as the simplifications described in paragraph BC191, the IASB is proposing to allow SMEs the option to apply the revised Section 23 prospectively. Additional disclosure requirements are being proposed to enable users to understand the effect on trend information when an SME applies the requirements prospectively.

BC193 The IASB's view is that the simplifications described in paragraph BC191 appropriately balance the costs and benefits of the requirements in Section 23. The revised Section 23 also expresses the requirements in IFRS 15 in simpler, more concise language when possible. The IASB's view is that these simplifications do not substantially change the underlying principles in IFRS 15 and would not affect faithful representation. Nevertheless, using simpler language in this section may lead to outcomes that are different from the outcomes of applying IFRS 15.

Section 28 *Employee Benefits*

Termination benefits

BC194 The 2011 amendments to IAS 19 *Employee Benefits* clarified that termination benefits should be recognised at the earlier of:

(a) when an entity can no longer withdraw the offer of those benefits; and

(b) when any related restructuring costs are recognised.

BC195 In the Request for Information, the IASB asked for views on aligning the recognition requirements for termination benefits in Section 28 *Employee Benefits* with the requirements in IAS 19. Most respondents agreed with aligning the recognition requirements for termination benefits with the 2011 amendments to IAS 19. The IASB agreed with these respondents and is of the view that aligning the recognition requirements for termination benefits would enable an entity to provide information that faithfully represents its liabilities. The aligned requirements would enable this by requiring the entity to recognise a liability for termination benefits only when the entity has an obligation that it has no practical ability to avoid.

BC196 The IASB noted that paragraph 28.35 of the Standard states 'An entity is demonstrably committed to a termination only when the entity has a detailed formal plan for the termination and without realistic possibility of withdrawal of the plan'. Therefore, aligning Section 28 with the 2011 amendments to IAS 19 is a clarification of the current requirements.

Removing the measurement simplifications for defined benefit obligations

BC197 Section 28 requires an entity to use the projected unit credit method to measure its defined benefit obligation and the related expense if the entity is able to do so without undue cost or effort. Paragraph 28.19 of the Standard permits an entity to make simplifications in measuring its defined benefit obligation with respect to current employees.

BC198 Before publishing the Request for Information, the IASB received questions on applying the measurement simplifications permitted by paragraph 28.19, including:

(a) whether discounting is required when applying the simplifications;

(b) how an entity applies paragraph 28.19; and

(c) the meaning of 'ignore future service' in paragraph 28.19(b).

BC199 In the Request for Information, the IASB asked for views on applying the simplifications in paragraph 28.19.

BC200 Some respondents to the Request for Information said some entities applying paragraph 28.19(b) are measuring their defined benefit obligations, for particular types of defined benefit plans, without discounting, because they assume all employees retire at the reporting date. Without discounting the defined benefit obligation could be overstated. Furthermore, some respondents asked what assumptions an entity can ignore when applying paragraph 28.19(b), that is, ignoring the future service of current employees. The IASB observed that the feedback suggests there is diversity in the application of the simplifications in paragraph 28.19, which results in diversity in measuring defined benefit obligations.

BC201 Feedback on the Request for Information also provided evidence that only a few entities apply paragraph 28.19. Therefore, the IASB is proposing to remove the measurement simplifications by deleting paragraph 28.19.

BC202 However, the IASB noted that if feedback on the Exposure Draft disagreed with removing paragraph 28.19, it could consider clarifying how to apply the measurement simplifications. Therefore, the IASB is asking, in the Invitation to Comment on the Exposure Draft, whether application of the measurement simplifications in paragraph 28.19 is limited and therefore whether it should delete paragraph 28.19 or, alternatively, whether it should clarify paragraph 28.19 by:

(a) stating that an entity may apply any, or all, of the simplifications permitted by paragraph 28.19 when measuring a defined benefit obligation; and

(b) explaining that, when an entity applies paragraph 28.19(b), examples of future service of current employees (assumes closure of the plan for existing employees and for any new employees) that can be ignored include:

  (i) the probability of employees not meeting the vesting conditions when the vesting conditions relate to future service (future turnover rate); and

  (ii) the effects of a benefit formula that gives employees greater benefits for later years of service.

BC203 The IASB is also proposing editorial amendments to Section 28 to improve the drafting and clarify when an entity discounts its defined benefit obligation.

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Section 33 *Related Party Disclosures*

BC204 Section 33 *Related Party Disclosures* includes the government-related entity exemption from IAS 24 *Related Party Disclosures* but does not include the additional disclosures required if an entity applies that exemption under IAS 24. Therefore, under Section 33, an entity is exempt from disclosing the nature of the relationship and also information about the transactions and outstanding balances with government-related entities. Feedback from users of SMEs' financial statements identified that information about related party transactions is important. Therefore, the IASB is proposing amendments:

(a) to align the basic disclosure requirements in Section 33 with paragraphs 25–26 of IAS 24. The IASB expects these disclosures will better enable users of SMEs' financial statements to understand the effect of the related party transactions covered by the exemption.

(b) to change the term 'state' in Section 33 to 'government' to align it with IAS 24 (which would also align the terminology with Section 24 *Government Grants*).

BC205 The IASB is also proposing minor amendments to Section 33 to add clarity and align with IAS 24 to improve information for users of SMEs' financial statements:

(a) to replace the heading before paragraph 33.5 of the Standard with one that better describes the content of paragraph 33.5;

(b) to specify in paragraph 33.9(b) of the Standard that an entity shall disclose commitments in addition to disclosing outstanding balances; and

(c) to require an entity to disclose separately the amounts it incurred for the provision of key management services provided by a separate management entity to align with amendments to IAS 24 in *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013.

Disclosure requirements within sections

BC206 The IASB developed the disclosure requirements in the Standard using the disclosure requirements in full IFRS Accounting Standards as a starting point, and then assessing users' needs and applying the principles set out in paragraph BC157 of the Basis for Conclusions on the Standard. As part of the stakeholder engagement on the Request for Information, interviews were held with users of SMEs' financial statements and feedback was also obtained via an online user survey. Most users who provided feedback agreed that the principles in paragraph BC157 continue to be appropriate for setting disclosure requirements in the Standard.

BC207 In July 2021, the IASB issued Exposure Draft ED/2021/7 *Subsidiaries without Public Accountability: Disclosures*, which sets out the IASB's proposal for a new IFRS Accounting Standard that would permit a subsidiary without public accountability to apply reduced disclosure requirements when applying full

IFRS Accounting Standards. In developing the disclosure requirements in ED/2021/7, the IASB used the Standard as the starting point.

BC208 The IASB developed the disclosure requirements proposed in ED/2021/7 using the following approach:

(a) when there is no recognition and measurement difference between the Standard and full IFRS Accounting Standards, the IASB used the disclosure requirements in the Standard but updated them to align terms and language with full IFRS Accounting Standards; and

(b) when recognition and measurement requirements differ, the IASB used the disclosure requirements in full IFRS Accounting Standards but tailored them by applying the principles it used in considering users' needs in the Standard—set out in paragraph BC157 of the Basis for Conclusions on the Standard.

BC209 The IASB is proposing amendments to the recognition and measurement requirements in many sections of the Standard to align them with full IFRS Accounting Standards during this comprehensive review. Therefore, the IASB also considered whether corresponding changes to disclosure requirements are needed. The IASB views the disclosures in ED/2021/7 as an appropriate basis for amending disclosures in the Standard during this review because of the approach taken to developing ED/2021/7 (see paragraph BC208), which would prioritise consistency between these disclosure requirements and ED/2021/7.

BC210 The IASB is proposing three possible outcomes for each section:

(a) **retain unchanged** the disclosure requirements in the sections of the Standard with recognition and measurement requirements that the IASB is not proposing to amend.

(b) **align** disclosure requirements with the proposals in ED/2021/7 in the sections of the Standard that the IASB is proposing to align with the recognition and measurement requirements in full IFRS Accounting Standards.

(c) **partly align** disclosure requirements with the proposals in ED/2021/7 in the sections of the Standard that the IASB is proposing to partly align with the recognition and measurement requirements in full IFRS Accounting Standards. Partly aligning these requirements means the IASB would:

  (i) retain unchanged those disclosure requirements in the section of the Standard that the IASB is not proposing to align with the recognition and measurement requirements in full IFRS Accounting Standards;

  (ii) align those disclosure requirements with the proposals in ED/2021/7 that the IASB is proposing to align with the recognition and measurement requirements in full IFRS Accounting Standards; and

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(iii) simplify those disclosure requirements in full IFRS Accounting Standards by applying paragraph BC157 of the Basis for Conclusions on the Standard, when the IASB is proposing to simplify the recognition and measurement requirements in full IFRS Accounting Standards.

BC211 The disclosure requirements for which the IASB is proposing substantive amendments are in Section 11 *Financial Instruments*, Section 19 *Business Combinations and Goodwill*, Section 23 *Revenue from Contracts with Customers*, Section 28 *Employee Benefits*, Section 33 *Related Party Disclosures* and Section 34 *Specialised Activities*. Minor amendments are included in other sections.

BC212 Proposed new disclosure requirements relating to the transition to the new edition of the Standard are also included in the Exposure Draft.

Multiple sections of the *IFRS for SMEs* Accounting Standard

BC213 In the Request for Information, the IASB asked for views on aligning multiple sections of the Standard with minor amendments to IFRS Accounting Standards and IFRIC Interpretations.[11]

BC214 In developing the Exposure Draft, the IASB considered the feedback and decided:

(a) to propose aligning the Standard with some new requirements resulting from amendments to IFRS Accounting Standards and IFRIC Interpretations, because these new requirements:

(i) are relevant to SMEs;

(ii) would not introduce extra complexity for SMEs; and

(iii) would introduce clarification to assist SMEs to prepare financial statements that faithfully represent the substance of economic phenomena in words and numbers, without significantly changing the requirements in the Standard.

(b) not to propose aligning the Standard with other amendments to IFRS Accounting Standards and IFRIC Interpretations, because:

(i) many of these new requirements are not relevant to SMEs; and/or

(ii) other new requirements contained more detail or required more information to be disclosed than SMEs and users of their financial statements typically require.

BC215 Tables A1–A2 accompanying this Basis for Conclusions categorise the amendments to IFRS Accounting Standards and IFRIC Interpretations based on whether the IASB is:

11 The minor amendments to IFRS Accounting Standards were grouped into tables A1–A5 in Appendix A of the Request for Information.

(a) proposing to align the Standard with the listed amendments to IFRS Accounting Standards and IFRIC Interpretations; and

(b) not proposing to align the Standard with the listed amendments to IFRS Accounting Standards and IFRIC Interpretations.

Disclosure of changes in liabilities from financing activities (Section 7)

BC216 In the Request for Information, the IASB asked for views on aligning the Standard with the 2016 Amendments to IAS 7 *Disclosure Initiative*. These amendments to IAS 7 *Statement of Cash Flows* require a disclosure of changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

BC217 Some respondents and SMEIG members expressed concerns about the difficulty that would be introduced by aligning the Standard with this amendment. However, feedback from the user survey and interviews with users of SMEs' financial statements confirmed that users are particularly interested in information about liquidity and solvency. Most respondents to the user survey and users interviewed supported requiring a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities.

BC218 In the Exposure Draft ED/2021/7 *Subsidiaries without Public Accountability: Disclosures* (ED/2021/7), the IASB proposed simplifying the disclosure requirements from the 2016 Amendments to IAS 7 by only proposing disclosure of a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. ED/2021/7 does not include the disclosure objective from the 2016 Amendments to IAS 7. Therefore, the disclosure requirements in ED/2021/7 are simpler to apply than in IAS 7 because an eligible subsidiary would not need to apply judgement to decide whether the reconciliation provides sufficient information to enable users of financial statements to evaluate changes in liabilities arising from financing activities.

BC219 The IASB is proposing the same simplification in the Exposure Draft. The IASB observed that because SMEs do not typically have complex liabilities arising from financing activities, in most cases the reconciliation would provide sufficient information about an entity's financial activities. The IASB considers the simplification balances the cost to SMEs of providing the disclosure and the benefit to users of improved information about an SME's financing activities.

Agriculture: Bearer Plants (Section 34)

BC220 In 2014, the IASB issued Amendments to IAS 16 and IAS 41 *Agriculture: Bearer Plants*, to require that bearer plants, such as grape vines, rubber trees and oil palms, be accounted for in the same way as property, plant and equipment in IAS 16, because their use is like that of property, plant and equipment in manufacturing operations. The amendment provided relief under full IFRS Accounting Standards by requiring an entity to account for bearer plants

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applying IAS 16, which permits a cost model, rather than requiring fair value measurement applying IAS 41. The IASB was told that measuring the fair value of bearer plants was costly and complex.

BC221 The amendments to IAS 16 and IAS 41 are relevant to SMEs because some SMEs have bearer plants. Aligning the Standard with these amendments would change the information SMEs provide to users by separately accounting for bearer plants as property, plant and equipment. Section 34 *Specialised Activities* provides relief from fair value measurement for all biological assets, including bearer plants, only if fair value cannot be determined reliably without undue cost or effort. Therefore, in the Request for Information, the IASB asked for views on aligning the Standard with *Agriculture: Bearer Plants*, which would provide further relief for bearer plants.

BC222 Many respondents did not comment specifically on *Agriculture: Bearer Plants*, but offered overall agreement with aligning the Standard with the amendments to IFRS Accounting Standards in Table A1 in Appendix A of the Request for Information, which included *Agriculture: Bearer Plants*. Therefore, it was not clear whether their support for aligning the Standard with this amendment was based on specific agreement or a lack of a detailed objection. However, a few respondents and some SMEIG members expressed specific concerns about aligning Section 34 with *Agriculture: Bearer Plants*, because SMEs might find separately determining the fair value of produce growing on bearer plants costly and complex. Furthermore, separately measuring the bearer plant from the produce might provide little benefit to users of SMEs' financial statements, particularly if the SME uses the undue cost or effort exemption from fair value measurement in Section 34 for the growing produce.

BC223 Considering this feedback, the IASB is proposing to align the Standard with *Agriculture: Bearer Plants*, but providing an exemption that an entity would not be required to separate bearer plants from the produce growing on them if, at initial recognition, such separation would involve undue cost or effort.

BC224 The IASB considered but rejected an alternative approach suggested by some respondents to allow SMEs to choose to account for the 'entire' bearer plant (including the produce) as a single asset. This is not an option provided in full IFRS Accounting Standards and the IASB aims to restrict accounting policy options in the Standard because options reduce comparability and can increase complexity. Paragraphs BC208–BC209 of the Basis for Conclusions on the Standard explain the IASB's reasons for restricting accounting policy options in the Standard.

Editorial amendments

BC225 The IASB is also proposing editorial amendments throughout the Standard. These amendments are shown in marked-up text.

Topics the IASB considered but for which amendments are not proposed

IFRS 14 *Regulatory Deferral Accounts*

BC226 In 2014, the IASB issued IFRS 14 *Regulatory Deferral Accounts*. IFRS 14 provides requirements for regulatory deferral account balances that arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation. The Standard has no section that corresponds to IFRS 14. Therefore, entities applying the Standard cannot recognise regulatory deferral account balances if these balances would not be permitted or required to be recognised by other sections of the Standard.

BC227 The IASB observed that entities subject to rate regulation could be non-publicly accountable entities. Therefore, such entities could be in the scope of the Standard and the topic may be relevant. However, the IASB has an active project on Rate-regulated Activities which could lead to the replacement of IFRS 14. In the Request for Information, the IASB asked for views on not aligning the Standard with IFRS 14 as part of the second comprehensive review (that is, not including requirements for regulatory deferral account balances in the Standard). During a future review, the IASB could consider alignment with any new IFRS Accounting Standard that arises from its current project on Rate-regulated Activities.

BC228 Many respondents and the SMEIG agreed that the IASB should not align the requirements in the Standard with IFRS 14. Some respondents agreed that the IASB should wait before considering alignment because the IASB has a project on Rate-regulated Activities, which could lead to the replacement of IFRS 14. Some respondents said that rate-regulated entities are generally large, listed entities that do not meet the definition of an SME. Only a few respondents said that the topic may be relevant to some entities.

BC229 The IASB decided the feedback provided enough evidence not to propose aligning the Standard with IFRS 14 as part of this comprehensive review. Nevertheless, the IASB decided it would consider including requirements for regulatory assets and regulatory liabilities in a future review of the Standard, after considering the outcome of its project on Rate-regulated Activities.

IFRS 16 *Leases*

BC230 Section 20 *Leases* is based on IAS 17 *Leases*. In January 2016, the IASB completed its project to improve financial reporting for leases and issued IFRS 16 *Leases*. IFRS 16 superseded IAS 17. IFRS 16:

(a) eliminated, for lessees, the classification of leases as either operating leases or finance leases required by IAS 17 and introduced a single lessee accounting model.

(b) substantially carried forward the lessor accounting requirements in IAS 17. Accordingly, lessors continue to classify leases as operating leases or finance leases, and to account for those two types of leases differently.

BC231 IFRS 16 was issued after the first comprehensive review of the Standard was completed. Therefore, the IASB has not previously considered aligning the Standard with IFRS 16.

BC232 In developing the Request for Information, the IASB noted that leases provide an important source of funding to SMEs. Therefore, it sought views on aligning Section 20 with IFRS 16, simplifying some of the recognition, measurement and disclosure requirements of IFRS 16, as well as the language. In seeking views, the IASB noted that aligning the Standard with IFRS 16 could improve transparency about SMEs' financial leverage and capital employed. In the Request for Information, the IASB said financial statements prepared applying an aligned Section 20 would more faithfully represent SMEs' assets and liabilities and provide useful and relevant information to users.

BC233 Overall feedback on aligning Section 20 with IFRS 16 was mixed. Stakeholders generally suggested the IASB assess the costs and benefits of aligning the Standard with IFRS 16 even with simplifications, and obtain more information about the experience of entities applying IFRS 16, including via the Post-implementation Review of IFRS 16. Some stakeholders and some SMEIG members suggested improving disclosure requirements for operating leases instead of aligning the Standard with IFRS 16.

BC234 In the light of the feedback on the Request for Information, and from supplementary research, the SMEIG discussed three possible approaches:

(a) Approach 1—aligning Section 20 with IFRS 16 with possible simplifications (as described in the Request for Information);

(b) Approach 2—aligning Section 20 with the main principle of IFRS 16 by extending the accounting for finance leases in the Standard to all leases; and

(c) Approach 3—improving disclosure requirements for operating leases without changing the recognition and measurement requirements in the Standard.

BC235 SMEIG members expressed mixed views, and there was no consensus on which of the three approaches to recommend to the IASB for developing the Exposure Draft.

BC236 The IASB considered but rejected both Approach 2 and Approach 3, observing that:

(a) Approach 2 could be considered a subset of Approach 1. Therefore, there was no good reason to prevent SMEs from benefiting from the improved features and various reliefs in IFRS 16.

(b) Approach 3 essentially ignores the fact that a lessee obtains the right to use an underlying asset (an asset) and has an obligation to make lease payments (a liability). Therefore, it would be challenging to improve disclosure requirements for operating leases without amending the recognition and measurement requirements of Section 20.

BC237 As a result, the IASB applied its alignment principles to Approach 1. In considering the relevance to SMEs, the IASB observed that many stakeholders did not disagree that the topic is relevant to SMEs. Stakeholders said that:

(a) IFRS 16 introduces improvements to financial reporting, provides useful information to users and leads to greater transparency of assets and liabilities;

(b) a lessee obtains an asset and incurs a liability whether the entity is applying the Standard or applying IFRS 16; and

(c) property leases for long periods are becoming more common, increasing the need to recognise right-of-use assets and related liabilities to show significant leases in the statement of financial position.

BC238 The IASB also observed, in assessing the relevance to SMEs, that some stakeholders expressed concerns that introducing simplifications, as set out in the Request for Information:

(a) could be challenging because these simplifications might result in new application questions that preparers had not raised when implementing IFRS 16;

(b) could require adjustments to software developed to comply with the requirements in IFRS 16; and

(c) might not faithfully represent an SME's assets and liabilities.

BC239 The IASB also noted that a few stakeholders asserted that a simplified model for operating leases—in which a lessee would classify all cash payments within operating activities in the statement of cash flows—is sufficient for the information needs of users of SMEs' financial statements.

BC240 Overall, the IASB considered that the improvements to financial reporting introduced by IFRS 16 are relevant to SMEs because leases provide an important source of funding to SMEs. However, considering the mixed feedback on whether to align Section 20 with IFRS 16 at this time, IASB members' views on such alignment were also mixed.

BC241 Some IASB members disagreed with aligning Section 20 with IFRS 16 at this time. These IASB members were persuaded by feedback from some stakeholders that the costs and efforts of applying an aligned Section 20 for SMEs would outweigh the benefits for users of their financial statements because:

(a) alignment with IFRS 16 would introduce complexity for SMEs (for example, determining the lease term and the lease payments to measure the lease liability, or applying a discount rate to the lease payments). Further complications could arise if some requirements in IFRS 16 are simplified for SMEs without the IASB having further information about the experience of entities applying IFRS 16. The IASB needs to strike the right balance between simplification and alignment with IFRS 16.

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(b) feedback from lenders was that their lending decisions about SMEs were not entirely based on the SMEs' financial statements, but that other sources of information were important, such as forecast cash flow information.

(c) the IASB should wait to align Section 20 with IFRS 16 until it hears more feedback about how IFRS 16 is working in practice, including via:

  (i) any application questions submitted to the IFRS Interpretations Committee; and

  (ii) the post-implementation review.

BC242 Other IASB members agreed that aligning Section 20 with IFRS 16 at this time would be beneficial for SMEs because:

(a) the single accounting model in IFRS 16 is similar to the accounting for finance leases in the Standard. Therefore, SMEs and users of their financial statements are already familiar with the accounting model for leases in IFRS 16.

(b) most SMEs do not have sophisticated leases arrangements (for example, power purchase agreements) and the single accounting model in IFRS 16 is simpler than the requirements for finance leases in Section 20.

(c) IFRS 16 contains several simplifications and practical expedients to respond to concerns about the costs associated with requiring an entity to recognise right-of-use assets and lease liabilities. In some jurisdictions, the only incremental cost of applying an aligned Section 20 might be the cost associated with applying a discount rate to the lease payments. The Request for Information had suggested a simplification for the discount rate that could be used if the IASB decided to align Section 20 with IFRS 16—it was similar to the simplification introduced in Topic 842 *Leases* of US GAAP for lessees that are not public business entities.

(d) ensuring that all leases are recognised in the statement of financial position would improve comparability and provide better-quality information to users—for example, in assessing the repayment capacity of SMEs, lenders consider cash flows associated with leases and the maturity of lease commitments. In some jurisdictions, lenders access the information about leases via centralised credit registers if the information is not available in SMEs' financial statements.

(e) retaining the accounting for lessees in Section 20—for example, until the IASB gathers more feedback about how IFRS 16 is working in practice—would delay potential improvements and lead to a major divergence from full IFRS Accounting Standards on an important matter affecting most SMEs.

BC243 The IASB observed that not aligning Section 20 with the single accounting model in IFRS 16 at this time could be viewed as inconsistent with the proposed definitions of an asset (and of a liability) and therefore the revised Section 2. In developing IFRS 16, the IASB concluded that:

(a) the lessee's right to use an underlying asset meets both the previous (*Conceptual Framework for Financial Reporting*, issued in 2010) and current (*Conceptual Framework for Financial Reporting*, issued in 2018) definitions of an asset; and

(b) the lessee's obligation to make lease payments meets both the previous (*Conceptual Framework for Financial Reporting*, issued in 2010) and current (*Conceptual Framework for Financial Reporting*, issued in 2018) definitions of a liability.

BC244 The IASB weighed the costs and benefits of aligning Section 20 with IFRS 16 and decided:

(a) not to propose amendments to Section 20 at this time; and

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

BC245 In reaching this decision, the IASB:

(a) observed that cost is a pervasive constraint on the information that can be provided by financial reporting as set out in the revised Section 2—that is, reporting financial information imposes costs, and it is important that those costs are justified by the benefits to users in reporting that information.

(b) observed that the costs and efforts for SMEs to apply an aligned Section 20 (at this stage of IFRS 16's life cycle) might not be justified by the benefits to users.

(c) prioritised timing—that is, allowing for more experience of applying IFRS 16. The IASB noted findings from the projects on its work plan may provide additional information about the costs and benefits of aligning Section 20 with IFRS 16 including:

  (i) both the IFRS Interpretations Committee and the IASB have projects on their work plans related to IFRS 16; and

  (ii) the post-implementation review of IFRS 16 has not yet started.

BC246 The IASB decided to ask for further information on cost–benefit considerations in the Invitation to Comment on the Exposure Draft. The IASB is asking whether:

(a) aligning Section 20 with IFRS 16 at this time imposes a workload on SMEs disproportionate to the benefit to users of their financial statements—specifically, considering:

  (i) the implementation costs that preparers of financial statements could incur;

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(ii) the costs that users of financial statements could incur when information is unavailable; and

(iii) the improvement to financial reporting that would be realised from recognising the lessee's right to use an underlying asset (and the lessee's obligation to make lease payments) in the statement of financial position; and

(b) introducing possible simplifications—for example, for determining the discount rate and the subsequent measurement of the lease liability (reassessment)—could help to simplify the requirements and reduce the cost of implementing an aligned Section 20 without reducing the usefulness of the reported information.

Cryptocurrency

BC247 The Standard does not include specific requirements for cryptocurrency and related transactions. In the Request for Information, the IASB asked for information on the prevalence of holdings of cryptocurrency and issuance of cryptoassets among SMEs to help the IASB decide whether the Standard should include requirements for holdings of cryptocurrency and issuance of cryptoassets.

BC248 Many respondents and SMEIG members said that in their jurisdictions holdings of cryptocurrency and issuance of cryptoassets were uncommon among SMEs. Some SMEIG members said that the IASB should complete research and standard-setting on cryptocurrency as part of its work on full IFRS Accounting Standards before considering requirements for the Standard.

BC249 The IASB agreed with the views of respondents and the advice of SMEIG members that the Standard should follow full IFRS Accounting Standards. Therefore, it decided against developing requirements for holdings of cryptocurrency or for issuing cryptoassets. The IASB decided to revisit this topic in the next comprehensive review of the Standard in the light of any future research and standard-setting completed during projects for full IFRS Accounting Standards.

Requirements for non-current assets held for sale and discontinued operations

BC250 The IASB considered requests from some respondents to add definitions or requirements relating to discontinued operations and assets held for sale—that is, to align the Standard with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

BC251 The IASB observed that the disclosure requirements in paragraph 4.14 of the Standard address disposals of major assets or groups of assets and that adding presentation requirements based on requirements in IFRS 5 would introduce complexity.[12] The IASB has not identified other significant relevant information that enhanced disclosure requirements would provide.

BC252 The IASB is proposing amendments to paragraph 4.14(b) of the Standard to remove the phrase 'or plan' because the disclosures only apply to a situation in which an entity has a binding sale agreement rather than other plans to sell or dispose of an asset or a group of assets and liabilities. The IASB is also proposing amendments to paragraph 5.11 of the Standard to clarify that the required analysis may be included in a note, separately from the primary statements.

Recognition and measurement requirements for development costs

BC253 As a simplification, the Standard requires all development costs to be recognised as expenses, whereas IAS 38 *Intangible Assets* requires the recognition of intangible assets arising from development costs that meet specified criteria. This simplification in the Standard was made for cost–benefit reasons. In particular, when the IASB was developing the Standard, feedback suggested that SMEs do not have the resources to assess whether a project is commercially viable on an ongoing basis and lenders disregard information about capitalised development costs in making lending decisions about SMEs (see paragraph BC113 of the Basis for Conclusions on the Standard).

BC254 A few respondents to the Request for Information said the IASB should amend the recognition and measurement requirements for development costs in the Standard to permit an SME to recognise intangible assets arising from development costs meeting the criteria in paragraph 57(a)–(f) of IAS 38. The IASB noted that similar comments had been raised during the first comprehensive review of the Standard. However, the IASB had focused on the balance of costs and benefits and decided not to amend the recognition and measurement requirements for development costs in the Standard as part of the first comprehensive review.

BC255 SMEIG members agreed with amending the recognition and measurement requirements for development costs subject to the criteria in IAS 38—that is, either by introducing an accounting policy option or by introducing a requirement with an undue cost or effort exemption.

12 Paragraph 4.14 requires that if, at the reporting date, an entity has a binding sale agreement for a major disposal of assets, or a group of assets and liabilities, the entity shall disclose:

(a) a description of the asset(s) or the group of assets and liabilities;

(b) a description of the facts and circumstances of the sale or plan; and

(c) the carrying amount of the asset or, if the disposal involves a group of assets and liabilities, the carrying amount of those assets and liabilities.

BC256 During this second comprehensive review, the IASB acknowledged new information might be identified that would warrant amending the recognition and measurement requirements for development costs. However, the IASB is not proposing to amend the recognition and measurement requirements for development costs in the Exposure Draft. Instead, in the Invitation to Comment on the Exposure Draft, the IASB is asking about the costs and benefits of introducing an accounting policy option permitting an SME to recognise intangible assets arising from development costs meeting the criteria in paragraph 57(a)–(f) of IAS 38.

BC257 The IASB aims to restrict accounting policy options in the Standard because including more complex options generally increases complexity and options also reduce comparability. Nevertheless, the IASB considered the alternative of requiring an SME to recognise the development costs meeting the criteria in IAS 38 as intangible assets unless doing so involves undue cost or effort. However, the IASB is of the view that the undue cost or effort assessment for development costs would require judgement and would add complexity for all SMEs. The IASB continues to agree with its reasoning in paragraph BC253 and therefore thinks that typically SMEs should recognise development costs as expenses. Therefore, in applying the alignment principles, the IASB is of the view that introducing an accounting policy option would be more consistent with the principle of simplicity compared to introducing a requirement with an undue cost or effort exemption.

Other topics

BC258 In the Request for Information, the IASB asked respondents if there were any topics the Standard does not address that should be the subject of specific requirements and whether respondents would like to bring to the IASB's attention any additional issue relating to the Standard.

BC259 Respondents identified various topics including:

(a) requests that the Standard include requirements for:

(i) not-for-profit entities;

(ii) earnings per share and operating segments;

(iii) IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*;

(iv) non-governmental grants; and

(v) interim financial reporting;

(b) suggestions on requirements in the Standard:

(i) removing the requirement in paragraph 22.7(a) of the Standard that an entity presents unpaid issued equity instruments as an offset to equity in its statement of financial position;

(ii) amending the requirements in paragraph 26.15 of the Standard on share-based payments with settlement options to require equity-settled as the default treatment rather than cash-settled;

(iii) expanding the consolidation exemption in paragraph 9.3 of the Standard;

(iv) including a fallback option to IAS 38 for the subsequent measurement of intangible assets; and

(v) simplifying the measurement of loans from a director by measuring them at transaction price rather than at present value as required by Section 11;

(c) suggestions on disclosures:

(i) introducing specific disclosures in the Standard for tax authorities and lenders; and

(ii) simplifying disclosures in the Standard for related party transactions;

(d) suggestions to include guidance and clarification:

(i) identifying the inconsistencies between the Standard and the European Accounting Directive;

(ii) clarifying whether a new IFRS Accounting Standard can be applied by an entity applying the Standard;

(iii) adding guidance for the application of present value techniques under conditions of uncertainty; and

(iv) adding guidance on the subsequent measurement of biological assets measured at fair value less costs to sell;

(e) suggestions to permit accounting policy options for:

(i) capitalisation of borrowing costs;

(ii) subsequent measurement of investment property; and

(iii) recognition requirements for government grants; and

(f) suggestions to consider topics within the IASB's work plan or Third Agenda Consultation.

BC260 The IASB considered the topics in paragraph BC259, but is not proposing amendments to the Standard because:

(a) some suggestions would not meet the principle of relevance to SMEs (for example, the matter in paragraph BC259(a)(ii));

(b) some of these requirements are already considered in a published document or supporting material in relation to the Standard (for example, the matter in paragraph BC259(a)(iii));

(c) some of these requirements, if introduced or amended, would lead to the Standard including requirements before those requirements are considered for inclusion in full IFRS Accounting Standards (for example, the matter in paragraph BC259(a)(iv));

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(d) some suggestions would lead to inconsistency with full IFRS Accounting Standards (for example, the matter in paragraph BC259(b)(iii));

(e) some suggestions would not enhance the usefulness of financial statements prepared applying the Standard (for example, the matter in paragraph BC259(c)(ii));

(f) some suggestions would add complexity to the Standard (for example, the matters in paragraph BC259(e)); and

(g) some suggestions relate to an active project that the IASB is working on or one that was being considered as part of its Third Agenda Consultation, and thus should be considered in a future review of the Standard when the IASB has concluded its active project (for example, the matters in paragraph BC259(f)).

BC261 Most SMEIG members supported not proposing amendments to the Standard for the topics described in paragraph BC259.

Transition and effective date

Transition to the third edition of the *IFRS for SMEs* Accounting Standard

BC262 The IASB's approach in proposing transition requirements for entities initially applying the third edition of the Standard is to reflect the comparable transition requirements in new or amended IFRS Accounting Standards and IFRIC Interpretations, when possible, with simplifications when they are considered appropriate for SMEs.

BC263 The default approach to transition is to require retrospective application of new and amended paragraphs in the Standard, subject to paragraph 10.12 of the Standard. Paragraph 10.12 requires that if a change in accounting policy is applied retrospectively (whether because of a change in the Standard or a management decision), the policy is applied to comparative information for prior periods to 'the earliest date for which it is practicable, as if the new accounting policy had always been applied'. When it is impracticable to determine the effects for one or more prior periods, the policy is applied to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable.

BC264 Appendix A to the Standard sets out exceptions to the default approach to applying changes retrospectively. When exceptions are set out that permit application from the date of initial application of the third edition of the Standard, these are generally based on the exceptions in the related new or amended IFRS Accounting Standard or IFRIC Interpretation.

BC265 The transition requirements relating to Section 23 would permit fewer retrospective transition methods than IFRS 15. IFRS 15 allowed a cumulative adjustment on transition, and the IASB is proposing to exclude this method, because entities that can prepare the information for a cumulative adjustment also are likely to be able to determine a full retrospective adjustment, and those that cannot would be permitted to apply the revised Section 23 prospectively from the date of initial application.

BC266 If an entity prepares its first financial statements using the *IFRS for SMEs* Accounting Standard, it would apply the requirements in Section 35. The IASB is proposing to amend only one of these requirements in the third edition of the Standard—that involving revenue. The IASB is proposing to retain the accounting policy for contracts in progress at the date of first-time application, updated for the proposed requirements of Section 23.

Effective date of the third edition of the *IFRS for SMEs* Accounting Standard

BC267 The IASB is proposing a wide range of amendments to the *IFRS for SMEs* Accounting Standard as part of its second comprehensive review. Therefore, the IASB observed that sufficient time should be provided for SMEs to understand and prepare for the amendments. The IASB is proposing that the effective date of the third edition of the *IFRS for SMEs* Accounting Standard be a minimum of two years from the date when the third edition of the Standard is issued, with early application permitted.

Likely effects of the proposals

BC268 The IASB is committed to assessing and explaining its views about the likely benefits and costs of implementing its proposals, and the likely ongoing benefits and application costs of those proposals—these benefits and costs are collectively referred to as 'effects'. The IASB expects to gain further insight into the likely effects of its proposals from responses to the Exposure Draft and through analysis and stakeholder engagement activities.

BC269 Paragraphs BC27–BC37 describe the IASB's alignment approach to developing proposed amendments to the Standard. Acknowledging SMEs' limited resources, the IASB considered, separately for each requirement, the likely costs and benefits of aligning the Standard with a new requirement in full IFRS Accounting Standards in the scope of the review. The IASB has explained how it has applied its alignment approach for each amendment throughout this Basis for Conclusions. By using the IASB's alignment approach and separately assessing the likely costs and benefits of each new requirement in full IFRS Accounting Standards in the scope of the review, the IASB can be satisfied that an overall assessment of the proposed amendments to the Standard would be that the benefits of the information provided under the proposed amendments would outweigh the costs of implementing the proposals.

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Tables showing treatment of amendments to full IFRS Accounting Standards

A1 For amendments to full IFRS Accounting Standards in the scope of this second comprehensive review, the following table lists topics the IASB considered and for which it is proposing amendments to the *IFRS for SMEs* Accounting Standard.

Table A1—Overview of amendments to full IFRS Accounting Standards for which the IASB is proposing changes to the *IFRS for SMEs* Accounting Standard

Section	IFRS Accounting Standard/Amendment to IFRS Accounting Standards	Main paragraphs in the Exposure Draft
Section 2 *Concepts and Pervasive Principles*	*Conceptual Framework for Financial Reporting*	2.1–2.131
Section 3 *Financial Statement Presentation*	*Definition of Material* (Amendments to IAS 1 and IAS 8)	3.16
Section 3 *Financial Statement Presentation*	*Disclosure Initiative* (Amendments to IAS 1)	3.15A
Section 7 *Statement of Cash Flows*	*Disclosure Initiative* (Amendments to IAS 7)	7.19A
Section 8 *Notes to the Financial Statements*	*Disclosure of Accounting Policies* (Amendments to IAS 1 and IFRS Practice Statement 2)[13]	8.4–8.6
Section 9 *Consolidated and Separate Financial Statements*	IFRS 10 *Consolidated Financial Statements*	9.4–9.6A, 9.18–9.19 and 9.23B
Section 10 *Accounting Policies, Estimates and Errors*	*Definition of Accounting Estimates* (Amendments to IAS 8)[13]	10.14A–10.15
Section 11 *Financial Instruments*	IFRS 9 *Financial Instruments*	11.2, 11.4–11.5, 11.8(e), 11.9ZA, 11.11A, 11.13 (Examples—financial liabilities), 11.14(d), 11.41(g), 11.48(a)(v), 11.25 and 11.26A–11.26L

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13 This amendment to an IFRS Accounting Standard is outside the scope of the second comprehensive review, but the IASB is of the view that it is interrelated with other amendments the IASB is proposing and that SMEs could benefit from the improvements brought by the amendment without delay.

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Section	IFRS Accounting Standard/Amendment to IFRS Accounting Standards	Main paragraphs in the Exposure Draft
Section 11 *Financial Instruments*	*Prepayment Features with Negative Compensation* (Amendments to IFRS 9)	11.9(b)
Section 12 *Fair Value Measurement*	IFRS 13 *Fair Value Measurement* *Annual Improvements to IFRSs 2010–2012 Cycle* (IFRS 13) *Annual Improvements to IFRSs 2011–2013 Cycle* (IFRS 13)	12.1–12.32 and 12A.1–12A.8
Section 14 *Investments in Associates*	*Long-term Interests in Associates and Joint Ventures* (Amendments to IAS 28)	14.8(d) and 14.8(h)
Section 15 *Joint Arrangements*	IFRS 11 *Joint Arrangements*	15.1–15.8 and 15.16–15.18B
Section 16 *Investment Property*	*Transfers of Investment Property* (Amendments to IAS 40)	16.9
Section 16 *Investment Property*	*Annual Improvements to IFRSs 2011–2013 Cycle* (IAS 40)	16.3A
Section 17 *Property, Plant and Equipment*	*Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to IAS 16 and IAS 38)	17.21(c) and 17.22
Section 17 *Property, Plant and Equipment*	*Agriculture: Bearer Plants* (Amendments to IAS 16 and IAS 41)	17.3(a)
Section 18 *Intangible Assets other than Goodwill*	*Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to IAS 16 and IAS 38)	18.22A

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Section	IFRS Accounting Standard/Amendment to IFRS Accounting Standards	Main paragraphs in the Exposure Draft
Section 19 *Business Combinations and Goodwill*	IFRS 3 *Business Combinations* *Annual Improvements to IFRSs 2010–2012 Cycle (IFRS 3)* *Annual Improvements to IFRSs 2011–2013 Cycle* (IFRS 3) *Annual Improvements to IFRS Standards 2015–2017 Cycle* (IFRS 3)	19.1–19.26A, 19A.1–19A.15 and 19B.1–19B.19
Section 23 *Revenue from Contracts with Customers*	IFRS 15 *Revenue from Contracts with Customers* *Clarifications to IFRS 15* Revenue from Contracts with Customers	23.1–23.129
Section 26 *Share-based Payment*	*Annual Improvements to IFRSs 2010–2012 Cycle* (IFRS 2)	26.9
Section 26 *Share-based Payment*	*Classification and Measurement of Share-based Payment Transactions* (Amendments to IFRS 2)	26.14A–26.15C
Section 28 *Employee Benefits*	IAS 19 *Employee Benefits* (issued in 2011)	28.1(d)(ii), 28.34–28.35 and 28.41–28.41E
Section 29 *Income Tax*	*Recognition of Deferred Tax Assets for Unrealised Losses* (Amendments to IAS 12)	29.16A, 29.19(a) and 29.19A
Section 29 *Income Tax*	IFRIC 23 *Uncertainty over Income Tax Treatments*	29.34A–29.34D
Section 30 *Foreign Currency Translation*	IFRIC 22 *Foreign Currency Transactions and Advance Consideration*	30.8A

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Section	IFRS Accounting Standard/Amendment to IFRS Accounting Standards	Main paragraphs in the Exposure Draft
Section 33 *Related Party Disclosures*	IAS 24 *Related Party Disclosures* *Annual Improvements to IFRSs 2010–2012 Cycle* (IAS 24)	33.7A, 33.9(b), 33.11, 33.12(ha) and 33.15
Section 34 *Specialised Activities*	*Agriculture: Bearer Plants* (Amendments to IAS 16 and IAS 41)	34.2–34.2B

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A2 The following table lists amendments to full IFRS Accounting Standards in the scope of this second comprehensive review that the IASB considered but for which it decided not to propose amendments to the *IFRS for SMEs* Accounting Standard.

Table A2—Overview of amendments to full IFRS Accounting Standards for which the IASB is not proposing changes to the *IFRS for SMEs* Accounting Standard

Section	IFRS Accounting Standard/Amendment to IFRS Accounting Standards
Section 9 *Consolidated and Separate Financial Statements*	*Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (Amendments to IFRS 10, IFRS 11 and IFRS 12)
Section 9 *Consolidated and Separate Financial Statements*	*Annual Improvements to IFRS Standards 2014–2016 Cycle* (IFRS 12)
Section 9 *Consolidated and Separate Financial Statements*	*Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27)
Section 9 *Consolidated and Separate Financial Statements*	*Investment Entities: Applying the Consolidation Exception* (Amendments to IFRS 10, IFRS 12 and IAS 28)
Section 11 *Financial Instruments*	*Annual Improvements to IFRSs 2012–2014 Cycle* (IFRS 7)
Section 11 *Financial Instruments*	*Novation of Derivatives and Continuation of Hedge Accounting* (Amendments to IAS 39)
Section 14 *Investments in Associates*	*Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28)
Section 15 *Joint Arrangements*	*Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (Amendments to IFRS 10, IFRS 11 and IFRS 12)
Section 15 *Joint Arrangements*	*Accounting for Acquisitions of Interests in Joint Operations* (Amendments to IFRS 11)
Section 15 *Joint Arrangements*	*Annual Improvements to IFRS Standards 2015–2017 Cycle* (IFRS 11)
Section 18 *Intangible Assets other than Goodwill*	*Annual Improvements to IFRSs 2010–2012 Cycle* (IAS 38)
Section 20 *Leases*	IFRS 16 *Leases*
Section 21 *Provisions and Contingencies*	IFRIC 21 *Levies*

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Section	IFRS Accounting Standard/Amendment to IFRS Accounting Standards
Section 23 *Revenue from Contracts with Customers*	*Effective Date of IFRS 15*
Section 27 *Impairment of Assets*	*Recoverable Amount Disclosures for Non-Financial Assets* (Amendments to IAS 36)
Section 28 *Employee Benefits*	*Defined Benefit Plans: Employee Contributions* (Amendments to IAS 19)
Section 28 *Employee Benefits*	*Plan Amendment, Curtailment or Settlement* (Amendments to IAS 19)
Section 29 *Income Tax*	*Annual Improvements to IFRS Standards 2015–2017 Cycle* (IAS 12)
Section 34 *Specialised Activities*	IFRS 14 *Regulatory Deferral Accounts*
Section 35 *Transition to the* IFRS for SMEs *Accounting Standard*	*Annual Improvements to IFRSs 2011–2013 Cycle* (IFRS 1)
Section 35 *Transition to the* IFRS for SMEs *Accounting Standard*	*Annual Improvements to IFRS Standards 2014–2016 Cycle* (IFRS 1)
No equivalent section	*Applying IFRS 9* Financial Instruments *with IFRS 4* Insurance Contracts

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IFRS for SMEs® Accounting Standard

Illustrative Financial Statements

This guidance accompanies, but is not part of, the IFRS for SMEs *Accounting Standard*.

F1 Section 3 *Financial Statement Presentation* of the *IFRS for SMEs* Accounting Standard defines a complete set of financial statements and prescribes general requirements for presenting financial statements. Section 4 *Statement of Financial Position*, Section 5 *Statement of Comprehensive Income and Income Statement*, Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*, Section 7 *Statement of Cash Flows* and Section 8 *Notes to the Financial Statements* prescribe the format and content of the individual financial statements and notes. Other sections of the *IFRS for SMEs* Accounting Standard establish additional presentation and disclosure requirements. These illustrative financial statements show how those presentation and disclosure requirements might be met by a typical small or medium-sized entity. Of course, each entity will need to consider the content, sequencing and format of their presentation and the descriptions it uses for line items to achieve 'fair presentation' in that entity's particular circumstances. These illustrative financial statements should not be regarded as a template appropriate for all entities.

F2 The illustrative statement of financial position presents current assets followed by non-current assets, and presents current liabilities followed by non-current liabilities and then by equity (that is, the most liquid items are presented first). In some jurisdictions, the sequencing is typically reversed (that is, the most liquid items are presented last), and that is also permitted by the *IFRS for SMEs* Accounting Standard. In accordance with paragraph 3.22 of the *IFRS for SMEs* Accounting Standard, an entity may use titles for the financial statements other than those used in these illustrations.

F3 In accordance with paragraph 3.18, the illustrative financial statements present a single statement of comprehensive income and retained earnings in place of two separate statements—a statement of comprehensive income and a statement of changes in equity. An entity can take this approach if the only changes to its equity during the periods for which it presents financial statements arise from profit or loss, payment of dividends, corrections of prior period errors and changes in accounting policy. (Because no items of other comprehensive income are presented, this statement could have been titled 'Statement of income and retained earnings'.) Two statements of comprehensive income and retained earnings are provided to illustrate the alternative classifications of income and expenses, by nature and by function—see paragraph 5.11 of the *IFRS for SMEs* Accounting Standard.

F4 The illustrative financial statements are not intended to illustrate all aspects of the *IFRS for SMEs* Accounting Standard. The IFRS Foundation's *IFRS for SMEs* training material, available on the SME webpages of the IFRS Foundation's website (www.ifrs.org), contains, by section, further illustrations of the presentation and disclosure requirements of the *IFRS for SMEs* Accounting Standard.

F5 The *IFRS for SMEs* Accounting Standard does not require a statement of financial position at the beginning of the earliest comparative period. However, the illustrative statement of financial position includes a column for the opening statement of financial position to assist understanding of the calculations of the underlying amounts in the statement of cash flows.

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XYZ Group

Consolidated statement of comprehensive income and retained earnings for the year ended 31 December 20X2

(Alternative 1—Illustrating the classification of expenses by function)

	Notes	**20X2**	**20X1**
		CU	**CU**
Revenue	5	6,846,037	5,785,275
Cost of sales		(5,157,249)	(4,404,400)
Gross profit		1,688,788	1,380,875
Other income	6	88,850	25,000
Distribution costs		(175,550)	(156,800)
Administrative expenses		(810,230)	(660,389)
Other expenses		(106,763)	(100,030)
Finance costs	7	(26,366)	(36,712)
Profit before tax	8	658,729	451,944
Income tax expense	9	(270,250)	(189,559)
Profit for the year		388,479	262,385
Retained earnings at start of year		2,166,150	2,003,765
Dividends		(150,000)	(100,000)
Retained earnings at end of year		2,404,629	2,166,150

Note: In this format, the entity aggregates expenses according to their function (for example, cost of sales, distribution and administrative). As the only changes to XYZ Group's equity during the year arose from profit or loss and payment of dividends, it has elected to present a single statement of comprehensive income and retained earnings instead of separate statements of comprehensive income and changes in equity.

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XYZ Group

Consolidated statement of comprehensive income and retained earnings for the year ended 31 December 20X2

(Alternative 2—Illustrating the classification of expenses by nature)

	Notes	**20X2**	**20X1**
		CU	**CU**
Revenue	5	6,846,037	5,785,275
Other income	6	88,850	25,000
Changes in inventories of finished goods, work in progress and returns assets		6,416	10,595
Raw material and consumables used		(4,786,699)	(4,092,185)
Employee salaries and benefits		(936,142)	(879,900)
Depreciation and amortisation expense		(272,060)	(221,247)
Impairment of property, plant and equipment		(30,000)	–
Other expenses		(231,307)	(138,882)
Finance costs	7	(26,366)	(36,712)
Profit before tax	8	658,729	451,944
Income tax expense	9	(270,250)	(189,559)
Profit for the year		388,479	262,385
Retained earnings at start of year		2,166,150	2,003,765
Dividends		(150,000)	(100,000)
Retained earnings at end of year		2,404,629	2,166,150

Note: In this format, the entity aggregates expenses according to their nature (for example, raw materials and consumables, employee salaries and benefits, depreciation and amortisation, impairment and other expenses). As the only changes to XYZ Group's equity during the year arose from profit or loss and payment of dividends, it has elected to present a single statement of comprehensive income and retained earnings instead of separate statements of comprehensive income and changes in equity.

XYZ Group

Consolidated statement of financial position at 31 December 20X2

	Notes	20X2	20X1	20X0
		CU	CU	CU
ASSETS				
Current assets				
Cash		38,905	22,075	18,478
Trade and other receivables	10	585,548	573,862	521,234
Inventories	11	96,837	66,095	45,050
		721,290	662,032	584,762
Non-current assets				
Investment in associate	12	107,500	107,500	107,500
Property, plant and equipment	13	2,549,945	2,401,455	2,186,002
Intangible assets	14	850	2,550	4,250
Deferred tax asset	15	4,309	2,912	2,155
		2,662,604	2,514,417	2,299,907
Total assets		3,383,894	3,176,449	2,884,669
LIABILITIES AND EQUITY				
Current liabilities				
Bank overdraft	16	83,600	115,507	20,435
Trade and other payables	17	482,571	443,898	412,690
Interest payable	7	2,000	1,200	–
Current tax liability		271,647	190,316	173,211
Provision for warranty obligations	18	4,200	5,040	2,000
Current portion of employee benefit obligations	19	4,944	4,754	4,571
Current portion of obligations under finance leases	20	21,461	19,884	18,423
		870,423	780,599	631,330

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Non-current liabilities				
Bank loan	16	50,000	150,000	150,000
Long-term employee benefit obligations	19	5,679	5,076	5,066
Obligations under finance leases	20	23,163	44,624	64,508
		78,842	199,700	219,574
Total liabilities		949,265	980,299	850,904
Equity				
Share capital	22	30,000	30,000	30,000
Retained earnings	4	2,404,629	2,166,150	2,003,765
		2,434,629	2,196,150	2,033,765
Total liabilities and equity		3,383,894	3,176,449	2,884,669

Note: The *IFRS for SMEs* Accounting Standard does not require a statement of financial position at the beginning of the earliest comparative period. This opening statement of financial position is presented here, in the shaded column, to aid understanding of the calculations underlying amounts in the statement of cash flows.

XYZ Group

Consolidated statement of cash flows for the year ended 31 December 20X2

	Notes	20X2	20X1
		CU	CU
Cash flows from operating activities			
Profit for the year		388,479	262,385
Adjustments for non-cash income and expenses:			
Non-cash finance costs[(a)]		800	1,200
Non-cash income tax expense[(b)]		79,934	16,348
Depreciation of property, plant and equipment		270,360	219,547
Impairment loss		30,000	–
Amortisation of intangibles		1,700	1,700
Cash flow included in investing activities:			
Gain on sale of equipment		(63,850)	–
Changes in operating assets and liabilities:			
Decrease (increase) in trade and other receivables		(11,686)	(52,628)
Decrease (increase) in inventories		(30,742)	(21,045)
Increase (decrease) in trade and other payables[(c)]		37,833	34,248
Increase in current and long-term employee benefit payable		793	193
Net cash from operating activities		703,621	461,948
Cash flows from investing activities			
Proceeds from sale of equipment		100,000	–
Purchases of equipment		(485,000)	(435,000)
Net cash used in investing activities		(385,000)	(435,000)

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Cash flows from financing activities			
Payment of finance lease liabilities		(19,884)	(18,423)
Repayment of borrowings		(100,000)	–
Dividends paid		(150,000)	(100,000)
Net cash used in financing activities		(269,884)	(118,423)
Net increase (decrease) in cash and cash equivalents		48,737	(91,475)
Cash and cash equivalents at beginning of year		(93,432)	(1,957)
Cash and cash equivalents at end of year	23	(44,695)	(93,432)

(a) Finance costs paid in cash	25,566	35,512
(b) Income taxes paid in cash	190,316	173,211
(c) Includes unrealised foreign exchange loss	1,000	–

XYZ Group
Accounting policies and explanatory notes to the financial statements for the year ended 31 December 20X2

1. General information

XYZ (Holdings) Limited (the Company) is a limited company incorporated in A Land. The address of its registered office and principal place of business is _________. XYZ Group consists of the Company and its wholly-owned subsidiary XYZ (Trading) Limited. Their principal activities are the manufacture and sale of candles.

2. Basis of preparation and accounting policies

These consolidated financial statements have been prepared in accordance with the *IFRS for SMEs* Accounting Standard issued by the International Accounting Standards Board. They are presented in the currency units (CU) of A Land.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiary. All intragroup transactions, balances, income and expenses are eliminated.

Investments in associates

Investments in associates are accounted for at cost less any accumulated impairment losses.

Dividend income from investments in associates is recognised when the Group's right to receive payment has been established, it is probable that the economic benefits associated with the dividend will flow to the Group and the amount of the dividend can be measured reliably. Dividend income from investments in associates is included in other income.

Revenue recognition

Revenue from the sale of goods is recognised when the goods are delivered. Revenue from licensing candle-making patents for use by others is based on a percentage of revenue generated by the patent, as specified in the relevant licence agreement. Royalty revenue is recognised as the sales associated with the patent occur. Revenue is measured at the fair value of the consideration received or receivable, net of discounts and sales-related taxes collected on behalf of the government of A Land and a liability for expected returns.

Borrowing costs

All borrowing costs are recognised in profit or loss in the period in which they are incurred.

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Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and their corresponding tax bases (known as temporary differences). Deferred tax liabilities are generally recognised for all temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled (taxable temporary differences). Deferred tax assets are generally recognised for all temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled (deductible temporary differences). However, deferred tax assets are recognised only to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date and is adjusted to reflect the current assessment of future taxable profits. Any adjustments are recognised in profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the taxable profit (tax loss) of the periods in which the entity expects the deferred tax asset to be realised or the deferred tax liability to be settled, on the basis of tax rates that have been enacted or substantively enacted by the end of the reporting period.

Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is charged so as to allocate the cost of assets less their residual values over their estimated useful lives, using the straight-line method. The annual rates used for the depreciation of property, plant and equipment are:

Buildings	2%
Fixtures and equipment	10%–30%

If there is an indication that there has been a significant change in depreciation rate, useful life or residual value of an asset, the depreciation of that asset is revised prospectively to reflect the new expectations.

Intangible assets

Intangible assets are purchased computer software that is stated at cost less accumulated depreciation and any accumulated impairment losses. Computer software is amortised over its estimated life of five years using the straight-line method. If there is an indication that there has been a significant change in amortisation rate, useful life or residual value of an intangible asset, the amortisation is revised prospectively to reflect the new expectations.

Impairment of assets

At each reporting date, property, plant and equipment, intangible assets and investments in associates are reviewed for indications that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of any affected asset (or group of related assets) is estimated and compared with its carrying amount. If the estimated recoverable amount is lower, the carrying amount is reduced to its estimated recoverable amount and an impairment loss is recognised immediately in profit or loss.

Similarly, at each reporting date, inventories are assessed for impairment by comparing the carrying amount of each item of inventory (or group of similar items) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, its carrying amount is reduced to selling price less costs to complete and sell, and an impairment loss is recognised immediately in profit or loss.

If an impairment loss subsequently reverses, the carrying amount of the asset (or group of related assets) is increased to the revised estimate of its recoverable amount (selling price less costs to complete and sell, in the case of inventories). However, the carrying amount is not increased in excess of the amount that would have been determined had no impairment loss been recognised for the asset (or group of related assets) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Leases

Leases are classified as finance leases whenever the terms of a lease transfer substantially all the risks and rewards of ownership of the leased asset to the Group. All other leases are classified as operating leases.

Rights to assets held under finance leases are recognised as assets of the Group at the fair value of the leased property (or, if lower, the present value of minimum lease payments) at the inception of the lease. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are deducted in measuring profit or loss. Assets held under finance leases are included in property, plant and equipment, and depreciated and assessed for impairment losses in the same way as owned assets.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease.

Inventories

Inventories are stated at the lower of cost and selling price less costs to complete and sell. Cost is calculated using the first-in, first-out (FIFO) method. Inventories include a return asset which represents the right to recover goods expected to be returned by customers. The asset is measured at the former carrying amount of the goods less any expected costs to recover the goods and any expected reduction in value.

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Trade and other receivables

Most sales are made on the basis of normal credit terms (30 days from the date of invoice) and the receivables do not bear interest. Trade receivables are measured at cost, except when credit is extended to customers that are not expected to pay within one year from the date of delivery. In such instances, receivables are measured at amortised cost using the effective interest method. At the end of each reporting period, the carrying amounts of trade and other receivables are reviewed to assess whether there is any objective evidence that the amounts are not recoverable. If so, an impairment loss is recognised immediately in profit or loss.

Trade and other payables

Trade payables are obligations on the basis of normal credit terms and do not bear interest. Trade payables denominated in a foreign currency are translated into CU using the exchange rate at the reporting date. Foreign exchange gains or losses are included in other income or other expenses.

Customers may return any unused goods within 30 days and receive a full refund. The refund liability is the amount of consideration received or receivable that is expected to be refunded to customers in respect of returned goods.

Bank loans and overdrafts

Interest expense is recognised on the basis of the effective interest method and is included in finance costs.

Employee benefits—Long-service payment

The liability for employee benefit obligations relates to government-mandated, long-service payments. All full-time staff, excluding directors, are covered by the programme. A payment is made of 5% of salary (as determined for the 12 months before the payment) at the end of each of five years of employment. The payment is made as part of the December payroll in the fifth year. The Group does not fund this obligation in advance.

The Group’s cost and obligation to make long-service payments to employees are recognised during the employees’ periods of service. The cost and obligation are measured using the projected unit credit method, assuming a 4% average annual salary increase, with employee turnover based on the Group’s recent experience, discounted using the current market yield for high-quality corporate bonds.

Provision for warranty obligations

All goods sold by the Group are warranted to be free of manufacturing defects for a period of one year. Goods are repaired or replaced at the Group’s option. When revenue is recognised, a provision is made for the estimated cost of the warranty obligation.

3. Key sources of estimation uncertainty

Long-service payments

In determining the liability for long-service payments (explained in note 19), management must make an estimate of salary increases over the following five years, the discount rate for the next five years to use in the present value calculation and the number of employees expected to leave before they receive the benefits.

Refund liability for expected returns

In determining the liability for expected returns (included in other liabilities—see note 17), management must make an estimate of the candles expected to be returned by customers, which is based on historical rates of returns.

4. Restriction on payment of dividend

Under the terms of the bank loan and bank overdraft agreements, dividends cannot be paid to the extent that they would reduce the balance of retained earnings below the sum of the outstanding balance of the bank loan and the bank overdraft.

5. Revenue

	20X2	20X1
	CU	CU
Sale of goods	6,715,832	5,665,275
Royalties—licensing of candle-making patents	130,205	120,000
	6,846,037	5,785,275

6. Other income

Other income includes dividends received from an associate of CU25,000 in both 20X1 and 20X2 and a gain on the disposal of property, plant and equipment of CU63,850 in 20X2.

7. Finance costs

	20X2	20X1
	CU	CU
Interest on bank loan and overdraft	(21,250)	(30,135)
Interest on finance leases	(5,116)	(6,577)
	(26,366)	(36,712)

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8. Profit before tax

The following items have been recognised as expenses (income) in determining profit before tax:

	20X2	20X1
	CU	CU
Inventories recognised as an expense	5,157,249	4,404,400
Research and development cost (included in other expenses)	31,620	22,778
Foreign exchange loss on trade payables (included in other expenses)	1,000	–
Warranty expense (included in cost of sales*)	5,260	7,340
Impairment losses on trade receivables (included in other expenses)	70,807	71,108

*If the entity classified its expenses by nature in its income statement, this would say 'included in raw materials and consumables used'.

9. Income tax expense

	20X2	20X1
	CU	CU
Current tax	271,647	190,316
Deferred tax (note 15)	(1,397)	(757)
	270,250	189,559

Income tax is calculated at 40% (20X1: 40%) of the estimated assessable profit for the year.

Income tax expense for the year CU270,250 in 20X2 (CU189,559 in 20X1) differs from the amount that would result from applying the tax rate of 40% (both 20X2 and 20X1) to profit before tax because, under the tax laws of A Land, some employee compensation expenses (CU20,670 in 20X2 and CU16,750 in 20X1) that are recognised in measuring profit before tax are not tax-deductible.

10. Trade and other receivables

	20X2	20X1
	CU	CU
Trade debtors	528,788	528,384
Prepayments	56,760	45,478
	585,548	573,862

11. Inventories

	20X2	20X1
	CU	CU
Raw materials	60,776	36,450
Work in progress	1,140	900
Finished goods	13,640	10,570
Returns asset	21,281	18,175
	96,837	66,095

12. Investment in associate

The Group owns 35% of an associate whose shares are not publicly traded.

	20X2	20X1
	CU	CU
Cost of investment in associate	107,500	107,500
Dividend received from associate (included in other income)	25,000	25,000

13. Property, plant and equipment

	Land and buildings	Fixtures and equipment	Total
	CU	CU	CU
Cost			
1 January 20X2	1,960,000	1,102,045	3,062,045
Additions	–	485,000	485,000
Disposals	–	(241,000)	(241,000)
31 December 20X2	1,960,000	1,346,045	3,306,045

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Accumulated depreciation and impairment			
1 January 20X2	390,000	270,590	660,590
Annual depreciation	30,000	240,360	270,360
Impairment	–	30,000	30,000
Less accumulated depreciation on assets disposed of	–	(204,850)	(204,850)
31 December 20X2	420,000	336,100	756,100
Carrying amount			
31 December 20X2	1,540,000	1,009,945	2,549,945

During 20X2 the Group noticed a significant decline in the efficiency of a major piece of equipment and so carried out a review of its recoverable amount. The review led to the recognition of an impairment loss of CU30,000.

The carrying amount of the Group's fixtures and equipment includes an amount of CU40,000 (20X1: CU60,000) in respect of assets held under finance leases.

On 10 December 20X2 the directors resolved to dispose of a machine. The machine's carrying amount of CU1,472 is included in fixtures and equipment at 31 December 20X2, and trade payables includes the Group's remaining obligation of CU1,550 on the acquisition of this machine. Because the proceeds on disposal are expected to exceed the net carrying amount of the asset and related liability, no impairment loss has been recognised.

14. Intangible assets

Software:

	CU
Cost	
1 January 20X2	8,500
Additions	–
Disposals	–
31 December 20X2	8,500

continued...

...continued

Accumulated depreciation and impairment	
1 January 20X2	5,950
Annual amortisation (included in administrative expenses*)	1,700
31 December 20X2	7,650
Carrying amount	
31 December 20X2	850

* If the entity classified its expenses by nature in its income statement, this would say 'included in depreciation and amortisation expense'.

15. Deferred tax

Differences between amounts recognised in the income statement and amounts reported to tax authorities in connection with investments in the subsidiary and associate are insignificant.

The deferred tax assets are the tax effects of expected future income tax benefits relating to:

(a) the long-service benefit (note 19), which will not be tax-deductible until the benefit is actually paid, but which has already been recognised as an expense in measuring the Group's profit for the year.

(b) the foreign exchange loss on trade payables, which will not be tax-deductible until the payables are settled, but which has already been recognised as an expense in measuring the Group's profit for the year.

Management considers it probable that taxable profits will be available against which the future income tax deductions can be utilised.

The deferred tax liabilities (assets) recognised by the Group are:

	Software	**Foreign exchange loss**	**Long-service benefit**	**Total**
	CU	**CU**	**CU**	**CU**
1 January 20X1	1,700	–	(3,855)	(2,155)
Charge (credit) to profit or loss for the year	(680)	–	(77)	(757)
1 January 20X2	1,020	–	(3,932)	(2,912)
Charge (credit) to profit or loss for the year	(680)	(400)	(317)	(1,397)
31 December 20X2	340	(400)	(4,249)	(4,309)

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The deferred tax assets for the foreign exchange loss and the long-service benefits and the deferred tax liability for software relate to income tax in the same jurisdiction, and the law allows net settlement. Consequently, they have been offset in the statement of financial position as follows:

	20X2	20X1
	CU	CU
Deferred tax liability	340	1,020
Deferred tax asset	(4,649)	(3,932)
	(4,309)	(2,912)

16. Bank overdraft and loan

	20X2	20X1
	CU	CU
Bank overdraft	83,600	115,507
Bank loan—fully repayable in 20X4, prepayable without penalty	50,000	150,000
	133,600	265,507

The bank overdraft and loan are secured by a floating lien over land and buildings owned by the Group with a carrying amount of CU266,000 at 31 December 20X2 (CU412,000 at 31 December 20X1).

Interest is payable on the bank overdraft at 200 points above the Sterling Overnight Index Average (Sonia). Interest is payable on the seven-year bank loan at a fixed rate of 5% of the principal amount.

17. Trade and other payables

	20X2	20X1
	CU	CU
Trade payables	454,858	420,520
Refund liability for expected returns	27,713	23,378
	482,571	443,898

Trade payables at 31 December 20X2 include CU42,600 denominated in foreign currencies (nil at 31 December 20X1).

18. Provision for warranty obligations

Changes in the provision for warranty obligations during 20X2 were:

	20X2
	CU
1 January 20X2	5,040
Additional accrual during the year	5,260
Cost of warranty repairs and replacement during the year	(6,100)
31 December 20X2	4,200

The obligation is classified as a current liability because the warranty is limited to 12 months.

19. Employee benefit obligation—Long-service payments

The Group's employee benefit obligation for long-service payments under a government-mandated plan is based on a comprehensive actuarial valuation as of 31 December 20X2 and is as follows:

	20X2
	CU
Obligation at 1 January 20X2	9,830
Additional accrual during the year	7,033
Benefit payments made in year	(6,240)
Obligation at 31 December 20X2	10,623

The obligation is classified as:

	20X2	**20X1**
	CU	**CU**
Current liability	4,944	4,754
Non-current liability	5,679	5,076
Total	10,623	9,830

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20. Obligations under finance leases

The Group holds one piece of specialised machinery with an estimated useful life of five years under a five-year finance lease. The future minimum lease payments are:

	20X2	20X1
	CU	CU
Within one year	25,000	25,000
Later than one year, but within five years	25,000	50,000
Later than five years	–	–
	50,000	75,000

The obligation is classified as:

	20X2	20X1
	CU	CU
Current liability	21,461	19,884
Non-current liability	23,163	44,624
	44,624	64,508

21. Commitments under operating leases

The Group rents several sales offices under operating leases. The leases are for an average period of three years, with fixed rentals over the same period.

	20X2	20X1
	CU	CU
Minimum lease payments under operating leases recognised as an expense during the year	26,100	26,100

At year-end, the Group has outstanding commitments under non-cancellable operating leases that fall due as follows:

	20X2	20X1
	CU	CU
Within one year	13,050	26,100
Later than one year, but within five years	–	13,050
Later than five years	–	–
	13,050	39,150

22. Share capital

Balances as at 31 December 20X2 and 20X1 of CU30,000 comprise 30,000 ordinary shares with par value CU1 fully paid, issued and outstanding. An additional 70,000 shares are legally authorised, but unissued.

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23. Cash and cash equivalents

	20X2	20X1
	CU	CU
Cash on hand	38,905	22,075
Overdrafts	(83,600)	(115,507)
	(44,695)	(93,432)

24. Reconciliation of liabilities arising from financing activities

	Bank loan	Finance leases	Total
	CU	CU	CU
1 January 20X1	(150,000)	(82,931)	(232,931)
Cash payments	30,135	25,000	55,135
Interest	(30,135)	(6,577)	(36,712)
31 December 20X1	(150,000)	(64,508)	(214,508)
Cash payments	121,250	25,000	146,250
Interest	(21,250)	(5,116)	(26,366)
31 December 20X2	(50,000)	(44,624)	(94,624)

25. Contingent liabilities

During 20X2 a customer initiated proceedings against XYZ (Trading) Limited for a fire caused by a faulty candle. The customer asserts that its total losses are CU50,000 and has initiated litigation claiming this amount.

The Group's legal counsel takes the view that the claim has no merit and the Company intends to contest the claim. No provision has been recognised in these financial statements as the Group's management has not deemed it probable that a loss will arise.

26. Events after the end of the reporting period

On 25 January 20X3 there was a flood in one of the candle storage rooms. The cost of refurbishment is expected to be CU36,000. The reimbursements from insurance are estimated to be CU16,000.

On 14 February 20X3 the directors voted to declare a dividend of CU1 per share (CU30,000 total) payable on 15 April 20X3 to registered shareholders on 31 March 20X3. Because the obligation arose in 20X3, a liability is not shown in the statement of financial position at 31 December 20X2.

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27. Related party transactions

Transactions between the Company and its subsidiary, which is a related party, have been eliminated in consolidation.

The Group sells goods to its associate (see note 12), which is a related party, as follows:

	Sales of goods		Amounts owed to the Group by the related party and included in trade receivables at year-end	
	20X2	**20X1**	**20X2**	**20X1**
	CU	**CU**	**CU**	**CU**
Associate	10,000	8,000	800	400

The payments under the finance lease (see note 20) are personally guaranteed by a principal shareholder of the Company. No charge has been requested for this guarantee.

The total remuneration of directors and other members of key management in 20X2 (including salaries and benefits) was CU249,918 (20X1: CU208,260).

28. Approval of financial statements

These financial statements were approved by the board of directors and authorised for issue on 10 March 20X3.

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