Comprehensive Review of the IFRS for SMEs

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The background

- In 2009, the International Accounting Standards Board (IASB) issued the IFRS for Small and Medium-sized Entities (IFRS for SMEs)

- The IFRS for SMEs is intended by the IASB for use by entities that have no public accountability and that are required, or choose, to publish general purpose financial statements for external users.

    - Essentially, an entity is considered to have public accountability if its debt or equity instruments are publicly traded, or if it is a financial institution or other entity that, as part of its primary business, holds and manages financial resources entrusted to it by clients

- For the purpose of performing post-implementation review on the standard, the IASB issued a request for information in June 2012
  - The objective of the Request for Information is to seek the views of those who have been applying the IFRS for SMEs, those who have been using financial information prepared in accordance with the IFRS for SMEs, national standard-setters, professional bodies, regulators and all other interested parties, on whether there is a need to make any amendments to the IFRS for SMEs and, if so, what amendments should be made

Method of collecting views

- Views are collected through
  - Questionnaire to AOSSG WG members

    (Australia, Brunei Darussalam, China, Hong Kong, India, Iraq, Korea, Malaysia, Pakistan, Thailand, and Uzbekistan)

Question S1 – Use by publicly traded entities

- Majority view: **<u>Current scope requirements are appropriate</u>**
  - IFRS for SMEs was initially designed for entities that do not have public accountability
  - Users of financial statements of public traded entities might seek significant amendments to the standard to satisfy their information needs if scoped in
  - Concerns on financial statements comparability in both inter-jurisdiction and intra-jurisdiction perspective

- Other views
  - Jurisdictions (especially in developing and under-developed countries whose economies are small) should be given the right to determine the eligibility to use IFRS for SMEs for publicly traded entities in their jurisdictions
  - Need to clarify the definitions of "publicly traded" and "public accountability"

Question S2 – Use by financial institutions

- Majority view: **<u>Current scope requirements are appropriate</u>**
  - Similar reasoning as for Question S1
- Other views
  - Certain financial institutions may not be publicly accountable (e.g. Restricted license banks)
  - Diverse interpretation on the term "fiduciary"
  - Permit IFRS for SMEs to be used by micro-finance institutions or smaller financial institutions

Question S3 – Clarification of use by not-for-profit entities

- Majority view: **NFP entities are generally not publicly accountable under the IFRS for SMEs**

- Views
  - Current standard is sufficiently clear – no revision is required
  - Incorporate clarifications in the standard that an NFP entity can use the IFRS for SMEs if it otherwise qualifies under Section 1
  - NFP entities may be subsidised by public funds – publicly accountable in the general sense of that term rather than under the IASB's specific definition

Question S4 – Consideration of recent changes to the consolidation guidance in full IFRSs

- Views

- IFRS 10 requirements should be incorporated as they provides users with useful guidance and application examples to assess control

- Continue to use the current definition of control and guidance on its application in Section 9 at this post-implementation review

    - IFRS 10 is more appropriate for larger and publicly accountable entities

    - IFRS 10 is more complex than IAS 27 and significant judgments are required

    - IFRS should be first implemented before the IASB considers whether to incorporate the new requirements into the IFRS for SMEs

Question S5 – Use of recognition and measurement provisions in full IFRSs for financial instruments

- Majority view: **Permit the option of either following the recognition and measurement provisions of IFRS 9 once it has become effective or following the provisions of Section 11 and 12 of IFRS for SMEs in full**

- Other views
  - Consider to update the option to use IAS 39 after implementation of IFRS 9
  - Should not include the requirements found in IFRS 9 if the standard is not to be used by financial institutions
  - No option should be provided - All SMEs must follow Section 11 and 12 for financial instrument accounting

Question S6 – Guidance on fair value measurement for financial and non-financial items

- Views

- Fair value guidance in IFRS for SMEs are not sufficient and support revising the standard to incorporate those aspects of the fair value in IFRS 13 that are relevant for SMEs

- Do not change the current requirements – IFRS 13 guidance on fair value would have no impact on the way fair value measurements are made under IFRS for SMEs in straightforward cases

Question S7 – Positioning of fair value guidance in the Standard

- Majority view: **Guidance on fair value measurement in Section 11 should be moved to a separate section given such guidance could also applied to non-financial items such as investments in associates and jointly controlled entities, investment properties, pension plan assets, business combinations and biological assets.**

Question S8 – Consideration of recent changes to accounting for joint ventures in full IFRSs

- Views

  - Revise IFRS for SMEs so that the arrangements are classified as joint ventures or joint operations on the basis of the parties of the parties' rights and obligations under the arrangement (i.e. IFRS 11 requirements)

    - Better reflection of the economic substance

  - Should only consider whether to build in the IFRS 11 requirements after the post-implementation review on IFRS 11

    - The implementation experience of full IFRS users will provide an insight on the suitability of the new requirements to SMEs

Question S9 – Revaluation of property, plant and equipment

- Majority view: **Revise the IFRS for SMEs to permit an entity to choose, for each major class of PPE, whether to apply the cost-depreciation-impairment model or the revaluation model**

    - Enhance the usefulness of their financial statements and to facilitate their loan financing

    - Revaluation model for PPE accounting has been applied in many jurisdictions and the requirements are generally considered not unreasonably difficult to apply

Question S10 – Capitalisation of development costs

- Majority view: **<u>revise the IFRS for SMEs to require capitalisation of development costs meeting the criteria for capitalisation (the approach in IAS 38)</u>**
  - SMEs should capitalise development costs provided that they are able to demonstrate that all of the criteria set out in paragraph 57 of IAS 38 are met.
  - Alternatively, if SMEs are not able to do so, SMEs should expense the development costs when they are incurred

Question S11 – Amortisation period for goodwill and other intangible assets

- Majority view: **<u>Retaining the presumption of ten years if an entity is unable to make a reliable estimate of the useful life of an intangible asset (including goodwill)</u>**
    - current requirement is sufficiently clear that the entity should not follow the 10-year presumption if it can determine the useful life at less than 10 years

Question S12 – Consideration of changes to accounting for business combination in full IFRSs

- Majority view: **Revising the IFRS for SMEs to incorporate the main changes introduced by IFRS 3 Business Combinations (2008). However, additional guidance on fair value should be provided which takes into account the main changes especially in the application of fair value to assist SMEs in applying the requirements of IFRS 3 (2008)**

- Other views

  - IFRS 3 (2008) addressed deficiencies in the previous version of IFRS 3 without changing the basic accounting. It is considered that the benefit of incorporating the requirements in IFRS 3 (2008) to IFRS for SMEs to a majority of the users of IFRS for SMEs may not be significant

  - Should provide an option for preparing consolidated financial statements or recording the investment in a subsidiary at cost to avoid undue cost or effort by preparers

Question S13 – Presentation of share subscriptions receivable

- Majority view: **an entity should have the necessary legal right to support its offset under paragraph 22.7(a) and it is believed to be difficult for IFRS for SMEs to incorporate a universal requirement to that effect**

- Views

  - Adding an additional option to paragraph 22(a) to permit the subscription receivable to be presented as an asset and therefore the entity would have a choice whether to present it as an asset or as an offset to equity

  - Deleting paragraph 27.7(a) from the IFRS for SMEs

Question S14 – Capitalisation of borrowing costs on qualifying assets

- Views
  - revising the IFRS for SMEs to require capitalisation of borrowing costs
    - Capitalisation of borrowing costs better reflect the underlying economics of the transaction
  - Revise the IFRS for SMEs to permit borrowing costs capitalisation
    - Such accounting treatment is more consistent with the principles of the Conceptual Framework
    - Entities which can deal with the complexity for capitalisation should not be deprived from such an accounting treatment

Question S15 – Presentation of actuarial gains or losses

- Majority view: **Revising the IFRS for SMEs so that an entity is required to recognise all actuarial gains and losses in other comprehensive income (i.e. removal of profit or loss option in paragraph 28.24)**
    - consistent with the latest applicable full IFRSs, will not require additional work by preparers, and would in turn enhance the comparability of financial statements

Question S16 – Approach for accounting for deferred income taxes

- Majority view: **<u>recognise deferred income taxes using the temporary difference method (the approach currently used in both the IFRS for SMEs and full IFRSs)</u>**
  - retain comparability between the financial statements of SMEs and publicly accountable entities on deferred income taxes
- Other views
  - Cost and benefit for recognising deferred income taxes would need to be carefully investigated from the perspective of SMEs
    - companies which are relatively smaller in size may consider that the costs of recognising deferred income taxes could easily outweigh the benefits in their financial reporting. In that case, the taxes payable method may be more suitable for their circumstances

- It may be preferable to adopt the liability method approach by considering the underlying costs and benefits in the perspective of SMEs and their financial statements users

Question S17 – Consideration of IAS 12 exemptions from recognising deferred taxes and other differences under IAS 12

- Majority view: **the section on income taxes, which is based on an IASB Exposure Draft that was not progressed to a standard, would need to be revised fully to be harmonised with IAS 12 Income Taxes**

    - The current approach in the IFRS for SMEs creates incomparability and does not provide any economy to SMEs

Question S18 – Rebuttable presumption that investment property at fair value is recovered through sale

- Majority view: **to incorporate a similar exemption to that found in full IFRSs from paragraph 29.20 for investment property at fair value**

    - By introducing a presumption that recovery of the carrying amount will normally be through sale, the standard would provide a practical solution to the difficulties on assessing whether the recovery of the carrying amount of the investment properties carried at fair value is through use or through sale

Question S19 – Inclusion of additional topics in the IFRS for SMEs

- A section based on IFRS 5 Non-current Assets Held for Sale and Discontinued operations

Question S20 – Opportunity to add specific issues

- Option of cost or fair value accounting on investment properties as in IAS 40 should be provided

- the requirements in IFRS for SMEs are still very complicated for the companies which are very small in size, including the preparation of consolidated financial statements, fair value measurement for financial instruments where it is hard to locate fair value information and deferred income taxes

Question G1 – Consideration of minor improvements to full IFRS

- Views
  - cost and benefit consideration
    - minor improvements to full IFRSs should be assessed from the perspective of SMEs particularly in relation to costs and benefits assessed in the context of the SME environment before a full IFRSs improvement be incorporated into the IFRS for SMEs
  - changes should only be made where there is a known problem in respect of SMEs financial reporting
    - There should be a rebuttable presumption that changes to full IFRSs should not be incorporated in the IFRS for SMEs

- Should develop criteria for assessing how any annual improvements to be incorporated in the IFRS for SMEs
    - The suggested criteria include: (i) cost and benefit consideration, (ii) the IFRS for SMEs should have the same key concepts and definitions as that in full IFRS and (iii) accounting policy options should be available for complicated areas

Question G2 – Further needs for Q&A

- Majority view: **The current Q&A programme should be continued as it is a useful resource to assist SMEs in applying the standard**
    - Useful guidance on accounting for more complicated business transactions and first-time adopter of the standard
- Other views
    - Q&As should be subject to full due process and issued by the IFRS Interpretations Committee
- A full IFRS adopter may well rely on them in preparing financial statements even though the documents are intended to have the status of informal guidance and not mandatory standards
    - IASB should continue to limit the issuance of Q&As to those issues that are genuinely causing difficulty in practice and to also seek to incorporate the responses into any future review of the full standard

Question G3 – Treatment of existing Q&As

- Views
  - the Q&As should be incorporated into the IFRS for SMEs or the training material depending on the details of the guidance
    - IASB should take extra care to avoid creating unintended new financial reporting requirements
  - any treatment of Q&As should have due attention to the fact they may affect full IFRSs preparers and should be consistent with the requirements of the IASB's due process in preparing standards and interpretations
  - the Q&As which have a fundamental impact should be incorporated in the IFRS for SMEs and the others retained as separate guidance

Question G4 – Training material

- Views
  - The training materials are adequate but should have illustrations of the double entries of a transaction to supplement the examples provided
  - IFRS Foundation should update the training modules when the standard is being updated following the post-implementation review
  - The IFRS Foundation should consider placing disclaimer wording in the training modules to warn users of full IFRSs not to use the training modules for their full IFRSs adoption, which is also not the original intention of the IASB on the production of training modules

Question G5 – Opportunity to add further general issues

- The AOSSG members did not raise any additional issue to bring to the IASB's attention in relation to the IFRS for SMEs

General issues identified

- In summary, diverse views were expressed by different jurisdictions
- SMEs in general have fewer available resources for financial reporting compared with listed entities
  - As with the initial version of the IFRS for SMEs, any proposed amendments should be assessed from the perspective of SMEs costs and benefits

Comments and questions