iGAAP in Focus

Financial reporting

IASB proposes amendments to the *IFRS for SMEs* Accounting Standard

Contents

This *iGAAP in Focus* outlines the proposals included in Exposure Draft (ED) IASB/ED/2022/1 *Third edition of the* IFRS for SMEs *Accounting Standard*, published by the International Accounting Standards Board (IASB) in September 2022.

- As part of its periodic review of the *IFRS for SMEs* Accounting Standard, the IASB has published an ED that proposes several amendments to the Standard
- Key proposed amendments include:
  - Clarifications to the definition of public accountability in Section 1 *Small and Medium-sized Entities*
  - Revision of Section 2 *Concepts and Pervasive Principles* to align with the 2018 *Conceptual Framework for Financial Reporting*
  - Alignment of Section 9 *Consolidated and Separate Financial Statements* with IFRS 10 *Consolidated Financial Statements*, introducing control as the single basis for consolidation that applies to all entities
  - Partial alignment of Section 11 *Financial Instruments* with IFRS 9 *Financial Instruments*
  - Introduction of a new Section 12 *Fair Value Measurement* that sets out the requirements for measuring fair value and disclosing information about fair value measurements
  - Partial alignment of Section 15 *Joint Arrangements* with IFRS 11 *Joint Arrangements*
  - Alignment of Section 19 *Business Combinations and Goodwill* with the acquisition method of accounting in IFRS 3 *Business Combinations*
  - Revision of Section 23 *Revenue from Contracts with Customers* to align with IFRS 15 *Revenue from Contracts with Customers* and include a new revenue recognition model
  - Removal of the measurement simplification for defined benefit obligations in Section 28 *Employee Benefits*
- The amendments would be applied retrospectively in accordance with Section 10 *Accounting Policies, Estimates and Errors*, with limited transition relief provided
- The effective date of the amended Standard is proposed to be at least two years from the date that the third edition of the *IFRS for SMEs* Accounting Standard is issued
- The comment period for the ED ends on 7 March 2023

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Background

The IASB maintains the *IFRS for SMEs* Accounting Standard through periodic review and proposes amendments to the Standard by publishing an omnibus exposure draft. In developing these exposure drafts, the IASB considers new and amended IFRS Accounting Standards as well as issues brought to its attention regarding the application of the Standard.

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 the previous comprehensive review. The ED is a result of the second comprehensive review.

The proposed amendments

The IASB proposes the following amendments to individual sections of the *IFRS for SMEs* Accounting Standard:

Preface of the *IFRS for SMEs* Accounting Standard	The IASB proposes an update of the preface in line with the 2018 update to the *Preface to IFRS Accounting Standards*.
Section 1 *Small and Medium-sized Entities*	The IASB proposes to clarify the definition of public accountability. The clarifications include a proposal to indicate that an entity with the following characteristics would usually have public accountability: • 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 • These users depend primarily on external financial reporting as their means of obtaining financial information about the entity. They need financial information about the entity but lack the power to demand the information for themselves
Section 2 *Concepts and Pervasive Principles*	The IASB proposes a revised Section 2 aligned with the 2018 *Conceptual Framework for Financial Reporting*. However, it proposes to retain the concept of 'undue cost or effort' that enables the IASB to continue providing relief to SMEs in specified circumstances.
Section 3 *Financial Statement Presentation*	The IASB proposes to clarify: • The requirements relating to materiality, order of the notes, subtotals, accounting policies and disaggregation • The definition of material and how it would be applied The IASB also proposes to require disclosure of 'material accounting policy information' instead of 'significant accounting policies'.
Section 4 *Statement of Financial Position*	The IASB proposes to require the disaggregation of line items in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.
Section 5 *Statement of Comprehensive Income and Income Statement*	The IASB proposes to clarify that an analysis of expenses may be either presented in the statement of comprehensive income or disclosed in the notes.
Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*	The IASB proposes to add a requirement to disclose dividends separately for ordinary shares and other shares.
Section 7 *Statement of Cash Flows*	The IASB proposes to add a requirement to disclose a reconciliation of changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash flows.

Section 8 *Notes to the Financial Statements*	The IASB proposes to require disclosure of 'material accounting policy information' instead of 'significant accounting policies' in line with the proposed amendment to Section 3.
Section 9 *Consolidated and Separate Financial Statements*	The IASB proposes to align the definition of control in Section 9 with the definition in IFRS 10 and to use that definition as the single basis for consolidation (control model) to facilitate greater consistency between financial statements prepared applying the Standard. The IASB also proposes to retain the rebuttable presumption that control exists when an investor owns more than a majority of the voting rights of an investee as a simplification of the control model. In addition, the IASB proposes to: • Set out requirements when a parent loses control of a subsidiary and to require entities to measure any retained interest in a former subsidiary at its fair value at the date control is lost • Relocate the requirements on changes in a parent's controlling interest in a subsidiary from Section 22 to Section 9 • Add a requirement to disclose information on losing control of a subsidiary, when the entity retains an investment in the former subsidiary • Require additional information in the separate financial statements of a parent, an investor in an associate or an investor with an interest in a jointly controlled entity
Section 10 *Accounting Policies, Estimates and Errors*	The IASB proposes consequential amendments to Section 10 arising from the removal of the option in Section 11 to apply the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement*. It is also proposed to introduce the definition of an accounting estimate to help entities distinguish changes in accounting estimates from changes in accounting policies.
Section 11 *Financial Instruments*	The IASB proposes to remove the option to apply the recognition and measurement requirements of IAS 39. With regard to impairment of financial assets, the IASB proposes to: • Retain the incurred loss model for trade receivables and contract assets in the scope of the revised Section 23 • Require an expected credit loss model for all other financial assets measured at amortised cost, aligned with the simplified approach in IFRS 9 • Retain the requirements in Section 11 for impairment of equity instruments measured at cost In addition, the IASB proposes to: • Add requirements for issued financial guarantee contracts • Clarify that debt instruments that have prepayment features with negative compensation payments could still meet the criteria to be measured at amortised cost • Add a supplementary principle for classifying debt instruments based on their contractual cash flow characteristics • Clarify the reclassification requirements for financial instruments • Relocate the requirements in Section 23 on the recognition of revenue from dividends to Section 11 • Relocate the requirements for estimating fair value and disclosing information about fair value measurements to the new Section 12 • Add disclosure requirements for entities that apply the expected credit loss impairment model • Relocate the requirements in Section 12 to a separate part of Section 11 • Remove contracts for contingent consideration in a business combination from the scope of Section 11 as a consequence of the proposed amendments to Section 19.

Observation

The Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* (RFI) asked for views on replacing the incurred loss model for the impairment of financial assets in Section 11 with an expected credit loss model aligned with the simplified approach in IFRS 9. Feedback suggested that the simplified approach in IFRS 9 would be complex for SMEs to apply and would not result in substantial changes in the amount of impairment for the types of financial assets held by typical SMEs, namely short-term trade receivables. Therefore, the IASB proposes to retain the incurred loss model for trade receivables and contract assets.

Section 12 *Fair Value Measurement*	The IASB proposes to align the Standard with the definition of fair value in IFRS 13 to provide clarity and enhance comparability between financial statements prepared applying the Standard. It is proposed that the requirements on measuring fair value and related disclosure requirements are consolidated in a new Section 12. No changes are proposed to when SMEs are permitted or required to measure an item at fair value.
Section 13 *Inventories*	The IASB proposes consequential amendments to the scope of Section 13 arising from the proposed amendments to Section 23 (i.e., to remove work in progress arising under construction contracts from the scope of Section 13).
Section 14 *Investments in Associates*	The IASB proposes to clarify the treatment for long-term interests in an associate or jointly controlled entity that form part of the entity's net investment in an associate or jointly controlled entity.
Section 15 *Joint Arrangements*	The IASB proposes to align the definition of joint control with IFRS 11 but to retain the classification and measurement requirements currently in Section 15. The term 'joint venture' would be replaced with 'joined arrangement'. The IASB also proposes to require an entity that does not have joint control of a joint arrangement to account for its interest based on the type of the arrangement. The IASB proposes further to: • Require entities to disclose information about their commitments relating to jointly controlled entities, rather than joint ventures • Remove the requirement for entities to disclose their share of the capital commitments of joint ventures
Section 16 *Investment Property*	The IASB proposes to: • Clarify that determining whether a transaction meets the definition of a business combination and includes an investment property requires separate application of Section 16 and Section 19 • Clarify that a property is transferred to or from investment property only when there is a change in use and to specify what constitutes a change in use • Relocate the requirement to disclose information about fair value measurements to the new Section 12

Section 17 *Property, Plant and Equipment*	The IASB proposes to: • Include bearer plants that are separately measurable without undue cost or effort within the scope of Section 17 • Clarify the factors considered in determining the useful life of an asset stating that expected future reductions in the selling price of an item produced using the asset could indicate the expectation of technical or commercial obsolescence of that asset • Clarify that a depreciation method based on revenue is not appropriate • Add consequential amendments to the date of disposal of an item, to align with the proposed amendments to Section 23 • Relocate the requirement to disclose information about fair value measurements to the new Section 12
Section 18 *Intangible Assets other than Goodwill*	The IASB proposes that Section 18 continues to use the previous definition of an asset and of a liability from Section 2, which was based on the 1989 *Framework*, to avoid unintended consequences arising from revising the definition of an asset and of a liability. The IASB also proposes to add a rebuttable presumption that amortisation methods based on revenue are not appropriate with detail of the limited circumstances in which it may be rebutted.

Observation

The *IFRS for SMEs* Accounting 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. However, feedback to the RFI questioned this cost-benefit decision. Therefore, the IASB is seeking views on whether it should amend the Standard to align it with IAS 38, including views on the costs and benefits of doing so.

Section 19 *Business Combinations and Goodwill*	The IASB proposes to align Section 19 with the acquisition method of accounting in IFRS 3 by: • Requiring an entity to apply the acquisition method of accounting to business combinations, rather than the purchase method • Adding requirements and guidance on identifying an acquirer, including when a new entity is formed to effect a business combination • Amending the recognition and measurement principles, including exceptions to the principles and clarifying that an acquirer cannot recognise a contingency that is not a liability • Requiring the recognition of acquisition-related costs as an expense and that contingent consideration be measured at fair value if the fair value can be measured reliably without undue cost or effort • Adding disclosure requirements about contingent consideration arrangements • Adding requirements for an acquisition achieved in stages The IASB further proposes to: • Clarify that the scope of Section 19 excludes the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself • Amend the definitions of a business and a business combination and introduce application guidance and illustrative examples on the definition of a business

Observation

The IASB proposes not to incorporate some of the IFRS 3 requirements and instead retain those in Section 19. The IASB is of the view that:

- The guidance in IFRS 3 on reacquired rights is unlikely to be relevant to entities applying the Standard
- Restricting the measurement of non-controlling interest in the acquiree to the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets (and not introducing the fair value option) is an appropriate simplification
- Retaining recognition criteria for intangible assets acquired in a business combination balances the costs and benefits of separate recognition of these items because goodwill recognised in a business combination is amortised

Section 20 *Leases*	The IASB decided not to propose amendments to Section 20 and to consider aligning the Standard with IFRS 16 during a future review.

Observation

The RFI asked for views on aligning Section 20 with IFRS 16 *Leases* by simplifying some of the recognition and measurement requirements, the disclosure requirements and the language of IFRS 16. Feedback on the RFI was mixed. Stakeholders suggested the IASB assess the costs and benefits of aligning the Standard with IFRS 16, even with the simplifications, and obtain more information about the experience of entities that apply IFRS 16.

Therefore, the IASB decided not to propose amendments to Section 20 at this time. In making this decision the IASB placed greater emphasis on cost-benefit considerations and prioritised timing—that is, to obtain more information on the experience of applying IFRS 16.

In the ED, the IASB asks for further information on cost-benefit considerations.

Section 21 *Provisions and Contingencies*	The IASB proposes that Section 21 continues to use the previous definition of an asset and of a liability from Section 2, which was based on the 1989 *Framework*, to avoid unintended consequences arising from revising the definition of an asset and of a liability. The IASB also proposes to: • Remove the guidance relating to contingent consideration in a business combination from the scope of Section 21 as a consequence of the proposed amendments to Section 19 • Relocate the guidance on restructuring costs from the Appendix to Section 21 • Remove the example on customer refunds from the Appendix to Section 21 as a consequence of the proposed amendments to Section 23
Section 22 *Liabilities and Equity*	The IASB proposes to: • Remove contracts for contingent consideration in a business combination from the scope exclusion of Section 22 as a consequence of the proposed amendments to Section 19 • Relocate the guidance on transactions in shares of a consolidated subsidiary to Section 9

Observation

Section 22 of the Standard states that if equity instruments are issued before an entity receives cash or other resources, the amount receivable is presented as an offset to equity in the statement of financial position, instead of being presented as an asset. The IASB received feedback that this requirement may conflict with local legislation. Stakeholders suggested that the requirement in Section 22 should be removed because it diverges from full IFRS Accounting Standards, which include no similar requirement for equity instruments. The IASB asks respondents to the ED for their views on this matter.

Section 23 *Revenue from Contracts with Customers*	The IASB proposes to revise Section 23 to align it with the principles and language used in IFRS 15. The revised requirements are based on the five-step model in IFRS 15, with simplifications that retain the basic principles in IFRS 15 for recognising revenue.
Section 24 *Government grants*	The IASB proposes only editorial amendments to Section 24.
Section 25 *Borrowing Costs*	The IASB proposes only editorial amendments to Section 25.
Section 26 *Share-based Payment*	The IASB proposes to: • Remove the following transactions from the scope of Section 26: – Business combinations – Combinations of entities or businesses under common control – Contribution of a business on the formation of a joint venture • Clarify the definition of 'fair value' used in Section 26 • Clarify the definition of 'vesting conditions' by separately defining a 'performance condition' and a 'service condition' • Adding requirements on the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments • Adding requirements on the classification of share-based payment transactions with a net settlement feature for withholding tax obligations
Section 27 *Impairment of Assets*	The IASB proposes to remove the requirement to disclose impairment losses recognised or reversed for inventories, as the requirement also appears in Section 13.

Section 28 *Employee Benefits*	The IASB proposes to: • Remove the measurement simplification for defined benefit obligations • Align the requirements on timing of the recognition of termination benefits with the requirements on recognition of restructuring costs in the scope of Section 21 • Require a more detailed reconciliation of the opening and closing balances of a defined benefit obligation, plan assets and any recognised reimbursement rights • Remove the requirement to disclose the total cost related to defined benefit plans for the period • Add a requirement for an entity that recognises and measures employee benefit expense on the basis of a reasonable allocation of the expense recognised for the group to disclose its contribution towards the group plan • Add an option for an entity that recognises and measures employee benefit expense on the basis of a reasonable allocation of the expense recognised for the group to disclose information about the group plan by cross-reference to the financial statements of another group entity if specific criteria are met • Add a requirement to disclose information about contingent liabilities arising from post-employment benefit obligations if required by Section 21

Observation

The RFI asked for views on the use of the measurement simplification for defined benefit obligations. The feedback identified challenges when applying those simplifications, resulting in diversity of application. However, the feedback also provided evidence that only a few entities apply the simplification. Therefore, the IASB proposes to remove the simplification.

Section 29 *Income Tax*	The IASB proposes to: • Clarify the requirements for when a deferred tax asset is recognised for unrealised losses • Add requirements on how to reflect the effects of uncertainty in the accounting for income taxes • Clarify the requirements for offsetting income tax assets and liabilities
Section 30 *Foreign Currency Translation*	The IASB proposes to add a requirement for determining the exchange rate to use in transactions that involve advance consideration paid or received in a foreign currency.
Section 31 *Hyperinflation*	The IASB proposes only editorial amendments to Section 31.
Section 32 *Events after the End of the Reporting Period*	The IASB does not propose any amendments to Section 32.

Section 33 *Related Party Disclosures*	The IASB proposes to: • Amend the heading related to the disclosure of controlling party relationships • Add a requirement to disclose amounts incurred by an entity for the provision of key management services that are provided by a separate management entity • Clarify the requirement to disclose information about commitments between an entity and its related parties • Replace the term 'state' with 'government' • Add commitments as an example of a related party transaction • Add a disclosure requirement for an entity that applies the exemption from disclosing information about the entity's relationship, and transactions, with government-related entities
Section 34 *Specialised Activities*	The IASB proposes to: • Add a requirement to account for bearer plants that at initial recognition can be measured separately without undue cost or effort in accordance with Section 17 • Remove the guidance on fair value measurement as a consequence of the new Section 12 and relocate the requirement to disclose information about the fair value measurement of biological assets in the new Section 12 • Add a requirement to treat exploration and evaluation assets as a separate class of assets and make the disclosures required by either Section 17 or Section 18
Section 35 *Transition to the* IFRS for SMEs *Accounting Standard*	The IASB proposes to: • Add an exception from retrospective application of the Standard on first-time adoption for contracts with customers completed before the date of transition • Add an option permitting first-time adopters to apply Section 23 retrospectively or prospectively, in line with the transitional requirements introduced for the revised Section 23
Appendix A *Effective date and transition*	The IASB proposes to provide requirements on transition to the third edition of this Standard.
Appendix B *Glossary of terms*	The IASB proposes consequential amendments arising from the proposed amendments to other sections of the Standard.
Derivation table	The IASB proposes consequential amendments arising from the proposed amendments to other sections of the Standard.

Transition, effective date and comment period

It is proposed that an entity applies amended and revised sections of the *IFRS for SMEs* Accounting Standard retrospectively in accordance with Section 10. Appendix A of the ED sets out limited relief from retrospective application for those proposed amendments for which the IASB thought the costs of retrospective application would exceed the benefits.

The effective date of the amended Standard is proposed to be at least two years from the date that the third edition of the *IFRS for SMEs* Accounting Standard is issued. Early adoption of the third edition of the *IFRS for SMEs* Accounting Standard in its entirety would be permitted.

The comment period ends on 7 March 2023.

Further information

If you have any questions about the proposed amendments to the *IFRS for SMEs* Accounting Standard, please speak to your usual Deloitte contact or get in touch with a contact identified in this *iGAAP in Focus*.

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