IFRS

STAFF PAPER

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IASB® meeting

Project	**Second Comprehensive Review of the *IFRS for SMEs®* Standard**
Paper topic	Towards an Exposure Draft—other topics with amendments recommended

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Introduction

1. This paper discusses topics raised in questions N4 and N5 of the Request for Information *Comprehensive review of the* IFRS for SMEs *Standard*, published in January 2020, for which the staff recommend the International Accounting Standards Board (IASB) propose amendments to the *IFRS for SMEs* Standard.

2. At its November 2021 meeting, the IASB discussed other topics raised in questions N4 and N5 of the Request for Information and agreed with the staff recommendation to retain the *IFRS for SMEs* Standard unchanged for those topics, except for the recognition and measurement of developments costs that the IASB will discuss at a future meeting.[1]

3. In this paper, the term SMEs refers to small and medium-sized entities that are eligible to apply the *IFRS for SMEs* Standard.

[1] See Agenda Paper 30E of the November 2021 IASB meeting and the November 2021 IASB Update.

Purpose of the paper

4. The purpose of this paper is to ask the IASB to:

   (a) consider feedback on the Request for Information and recommendations of the SME Implementation Group (SMEIG) on the topics discussed in this paper; and

   (b) decide whether to propose amendments to the *IFRS for SMEs* Standard for these topics.

Summary of staff recommendations

5. The staff recommend the IASB:

   (a) propose amendments to Section 22 *Liabilities and Equity* of the *IFRS for SMEs* Standard to remove paragraph 22.7(a) of the Standard;

   (b) discuss in the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard, or supporting material to the Exposure Draft, the inconsistencies between the *IFRS for SMEs* Standard and the European Accounting Directive;

   (c) propose amendments to Section 26 *Share-based Payment* of the *IFRS for SMEs* Standard to include in Section 26 the scope exclusions similar to those in paragraph 5 of IFRS 2 *Share-based Payment*; and

   (d) develop and propose amendments to Section 26 on share-based payment with settlement options to require equity-settled as the default treatment rather than cash-settled.

Structure of the paper

6. This paper is structured as follows:

   (a) questions in the Request for Information (paragraphs 7–9 of this paper);

   (b) methods for obtaining feedback (paragraphs 10–12 of this paper);

   (c) overall feedback and staff analysis:

(i) amendments to Section 22 *Liabilities and Equity* (paragraphs 14–31 of this paper);

(ii) amendments to Section 26 *Share-based Payment*—incorporating scope exclusion (paragraphs 32–39 of this paper);

(iii) amendments to Section 26 *Share-based Payment*—share-based payments with settlement options (paragraphs 40–52 of this paper); and

(d) staff recommendations and questions for the IASB (paragraph 53 of this paper).

Questions in the Request for Information

7. Question N4 of the Request for Information asked whether there are any topics the *IFRS for SMEs* Standard does not address that respondents think should be the subject of specific requirements (for example, topics not addressed by the Standard for which the general guidance in paragraphs 10.4–10.6 of the *IFRS for SMEs* Standard is insufficient).

8. Question N5 of the Request for Information asked respondents to describe any additional issues that they would like to bring to the IASB's attention relating to the *IFRS for SMEs* Standard.

9. This paper considers and discusses feedback on questions N4 and N5 together as 'other topics' because the staff noted that:

(a) some respondents commented on other topics in general; and

(b) in some cases, different respondents regarded the same topic as a topic not addressed by the *IFRS for SMEs* Standard or as an additional issue.

Methods for obtaining feedback

10. Feedback on questions N4 and N5 of the Request for Information were gathered from comment letters and an online survey.

11. On 9 September 2021, the SMEIG discussed staff preliminary thoughts for feedback on questions N4 and N5 of the Request for Information in three categories:

(a) topics for which further action is required;

(b) topics for which further action is not required; and

(c) topics for which the staff is asking for SMEIG's advice.

12. SMEIG members provided their feedback during the meeting and shared written comments in advance of the meeting.[2]

Overall feedback and staff analysis

13. The following sections of the paper discuss the feedback on the Request for Information, SMEIG recommendations and the staff analysis on the topics raised in questions N4 and N5 of the Request for Information for which the staff recommend the IASB propose amendments to the *IFRS for SMEs* Standard.

Amendments to Section 22 Liabilities and Equity

14. Section 22 *Liabilities and Equity* of the *IFRS for SMEs* Standard requires SMEs to recognise the issue of shares or other equity instruments as equity when another entity is obliged to provide cash or other resources to the entity in exchange for the instruments. Further, paragraph 22.7(a) of the *IFRS for SMEs* Standard sets out that if the equity instruments are issued before the entity receives the cash or other resources, the amount receivable is presented as an offset to equity in the balance sheet not as an asset.

Feedback on the Request for Information

15. One respondent suggested the IASB remove this requirement as the requirement in paragraph 22.7(a) of the *IFRS for SMEs* Standard is not a requirement of IFRS Standards, and thus leads to divergence between the *IFRS for SMEs* Standard and IFRS Standards.

16. It was noted that such requirement may be in conflict with local legislation, which regard equity as having been issued and require the presentation of the related receivable as an asset.

[2] See Agenda Paper 8 of the September 2021 SMEIG meeting and the SMEIG meeting report September 2021

17. Similarly, another respondent suggested the IASB consider other requirements in the *IFRS for SMEs* Standard which may be inconsistent with the European Accounting Directive. In this respondent's view further alignment of the *IFRS for SMEs* Standard with the European Accounting Directive would foster the adoption of the Standard within the European Union.

SMEIG recommendations

18. At the September 2021 SMEIG meeting, the staff asked SMEIG members whether the requirement in paragraph 22.7(a) of the *IFRS for SMEs* Standard conflicts with their local legislation.

19. Most SMEIG members said they were not aware that the requirement in paragraph 22.7(a) conflicts with their local legislation. However, one SMEIG member mentioned that there are several requirements of the *IFRS for SMEs* Standard that conflict with the European Accounting Directive.

Staff analysis

20. In the light of the feedback on the Request for Information and the SMEIG recommendations, the staff recommend the IASB:
    (a) propose to remove paragraph 22.7(a) of the *IFRS for SMEs* Standard; and
    (b) discussing in the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard, or supporting material to the Exposure Draft, the inconsistencies between the *IFRS for SMEs* Standard and the European Accounting Directive.

Removing paragraph 22.7(a) of the IFRS for SMEs *Standard*

21. The IASB discussed removing paragraph 22.7(a) as a possible amendment in the first comprehensive review of the *IFRS for SMEs* Standard.[3] At the time, the IASB concluded the amendment was unnecessary, however the staff are asking the IASB to revisit this assessment in the light of the arguments presented in this paper.

[3] See Agenda Paper 8G of the April 2013 IASB meeting and the IASB Update April 2013

22. The staff recommend the IASB propose to remove paragraph 22.7(a) of the *IFRS for SMEs* Standard because:

    (a) the requirement in paragraph 22.7(a) reflects a legal requirement rather than a financial capital market requirement and it would not be possible for the *IFRS for SMEs* Standard to incorporate a requirement which is universally accepted across all jurisdictions;

    (b) the *IFRS for SMEs* Standard should not set out the accounting treatment of related receivables on equity issuance if the IFRS Standard is silent as it should not contain a requirement additional to IFRS Standards; and

    (c) removing the requirement in paragraph 22.7(a) would enable consistent application of the definition of an asset and equity in Section 2 *Concepts and Pervasive Principles* in determining the presentation of related receivables on equity issuance.

23. Although most SMEIG members said they were not aware that the requirement of paragraph 22.7(a) conflicted with their local legislation, the staff note that there were no specific calls in favour of retaining the paragraph.

24. The staff also note that FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* had a similar requirement, but the requirement was subsequently removed as it conflicted with UK and Irish company law. FRS 102 is the Financial Reporting Standard applicable in the UK and Republic of Ireland derived from the *IFRS for SMEs* Standard but with modifications.

25. In weighing the costs and benefits of the staff recommendation, the staff note the implication of removing paragraph 22.7(a) may include the cost of changing the presentation in the statement of financial position if SMEs conclude that unpaid share capital does not meet the definition of equity and therefore needs to be recognised as asset.

26. However, in the staff's view, the benefit of removing paragraph 22.7(a) outweighs its costs as there would be no requirement for SMEs to make changes in the absence of instruction either way; SMEs would need to make their own assessment of the appropriate

presentation of unpaid share capital and may continue to conclude that it does not meet the definition of an asset and therefore needs to be retained as a deduction from equity.

27. The staff think the absence of paragraph 22.7(a) would reduce requirements in the *IFRS for SMEs* Standard that may conflict with local legislation in some jurisdictions.

Inconsistencies between the IFRS for SMEs *Standard and the European Accounting Directive*

28. An EFRAG study in 2011 reviewed the *IFRS for SMEs* Standard for inconsistences with the Fourth and Seventh European Council Directives (Directives) on accounting, which at that point were the relevant parts of EU law. EFRAG noted some incompatibilities at the time of their review (as noted in paragraph 29 many of these inconsistencies still apply when looking at consistency between the *IFRS for SMEs* Standard and the new single European Accounting Directive):

(a) the Directives allowed for a line item for ‘extraordinary items’ which is prohibited by the *IFRS for SMEs* Standard;

(b) section 12 of the *IFRS for SMEs* Standard requires some financial instruments to be measured at fair value, a basis which was not permitted by the Directives;

(c) the *IFRS for SMEs* Standard requires the fair value model for investments in associates and joint ventures for which there is a published price quotation; this basis was not permitted in the Directives;

(d) the *IFRS for SMEs* Standard presumes the useful life of goodwill to be 10 years if the useful life cannot be reliably estimated; in the Directives the permitted life was capped at five years;

(e) in the *IFRS for SMEs* Standard, negative goodwill is recognised immediately as a credit to the income statement; in the Directives it would have been retained in the statement of financial position and released on a prescribed basis;

(f) the *IFRS for SMEs* Standard prohibits reversal of an impairment loss relating to goodwill; the Directives treated impairment losses on goodwill similarly to other impairment losses; and

(g) paragraph 22.7 of the *IFRS for SMEs* Standard requires unpaid amounts relating to issued share capital to be treated as a deduction from equity; the Directives prescribed that they were to be treated as an asset (see paragraphs 21–27 of this paper).

29. In 2013 the Directives were consolidated into a single European Accounting Directive, which affected a small number of the inconsistencies. In particular, the new European Accounting Directive sets out that goodwill must be amortised over a minimum of five years and a maximum of the useful economic life. If its useful economic life cannot be determined, the life used must be between five and 10 years. This allows an entity to comply with both the European Accounting Directive and the *IFRS for SMEs* Standard.

30. The staff note that the *IFRS for SMEs* Standard was developed and designed to enable adoption and application globally and considering alignment of the *IFRS for SMEs* Standard with the European Accounting Directive, or with any other set of local legislation, to the exclusion of all others, would not make global adoption of the Standard attractive to other jurisdictions. However, the staff think the IASB would benefit from conducting work to clarify the inconsistencies between the *IFRS for SMEs* Standard and the European Accounting Directive.

31. The staff recommend discussing in the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard, or supporting material to the Exposure Draft, the inconsistencies between the *IFRS for SMEs* Standard and the European Accounting Directive.

Amendments to Section 26 Share-based Payment—incorporating scope exclusion

32. Paragraph 5 of IFRS 2 *Share-based Payment*, does not apply to transactions in which the entity acquires goods as part of the net assets acquired in a business combination, in a combination of entities under common control or the contribution of a business on the formation of a joint venture. Instead, paragraph 5 of IFRS 2 references IFRS 3 *Business Combinations* for requirements in determining whether equity instruments issued in a business combination are part of the consideration transferred in exchange for control of

the acquiree (and therefore within the scope of IFRS 3) or are in return for continued service to be recognised in the post-combination period.

Feedback on the Request for Information

33. A respondent suggested the IASB include the scope exclusions in paragraph 5 of IFRS 2 in Section 26 *Share-based Payment* of the *IFRS for SMEs* Standard. According to the respondent, incorporating these scope exclusions in the *IFRS for SMEs* Standard would simplify the accounting when businesses are acquired in a common control transaction or the contribution of a business on the formation of a joint venture. The lack of these exclusions has led to complexity in application and diversity in practice.

SMEIG recommendations

34. At the September 2021 SMEIG meeting, most SMEIG members agreed with staff preliminary thoughts to recommend the IASB include some scope exclusions in Section 26 of the *IFRS for SMEs* Standard similar to the scope exclusions in paragraph 5 of IFRS 2.

Staff analysis

35. The staff think the IASB should propose amendments to Section 26 of the *IFRS for SMEs* Standard to include scope exclusions similar to those of paragraph 5 of IFRS 2 because introducing these scope exclusions would be consistent with the principles of relevance to SMEs, simplicity and faithful representation.

Relevance to SMEs

36. The staff are of the view that including these scope exclusions in the *IFRS for SMEs* Standard:

(a) is consistent with the principle of relevance to SMEs as feedback from the Request for Information has indicated that common control transactions are prevalent among some SMEs; and

(b) would enhance users’ interpretation of the impact of common control transactions on SMEs.

Simplicity and faithful representation

37. The staff think that including these scope exclusions in the *IFRS for SMEs* Standard would clarify and simplify the application of the *IFRS for SMEs* Standard consistent with the principle of simplicity.

38. Additionally, the staff note that Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs* Standard contains sufficient guidance for SMEs to account for equity instruments issued in a business combination. For example, paragraph 19.11 of the *IFRS for SMEs* Standard sets out that the cost of business combination includes the equity instruments issued by the acquirer in exchange for control of the acquiree. As such, the staff think including this scope exclusion would not cause unnecessary complexity to SMEs.

39. Furthermore, the staff think that including these scope exclusions in the Section 26 of the *IFRS for SMEs* Standard would ensure faithful representation as it would better reflect economic reality of the business combination transaction, and further align the requirements of Section 26 of the *IFRS for SMEs* Standard with IFRS 2.

Amendments to Section 26 **Share-based Payment**—*share-based payments with settlement options*

40. Paragraph 26.15 of the *IFRS for SMEs* Standard requires share-based payment transactions that contain a settlement option to be accounted for as cash-settled share-based payment transactions—with measurement of the liability at fair value at each reporting date (default treatment), unless there is past practice of settling in equity instruments or the cash settlement option has no commercial substance.

Feedback on the Request for Information

41. A respondent suggested the IASB amend paragraph 26.15 of the *IFRS for SMEs* Standard to require equity-settled as the default treatment when share-based payment transactions

give either the entity or the counterparty a choice of settling the transaction in cash or transfer of equity. According to the respondent, applying cash-settled as the default treatment required by Section 26 of the *IFRS for SMEs* Standard is more onerous than applying the requirements in IFRS 2.

SMEIG recommendations

42. At the September 2021 SMEIG meeting, the staff asked SMEIG members for advice on whether the IASB should amend the requirements for share-based payment with settlement options in the *IFRS for SMEs* Standard to require equity-settled as the default treatment, rather than cash-settled, when share-based payment transactions give either the entity or the counterparty a choice of settlement.

43. There were mixed views among SMEIG members on whether further action is required for this topic. Some SMEIG members supported the IASB amending Section 26 the *IFRS for SMEs* Standard to require equity-settled rather than cash-settled as the default treatment because:

    (a) it will be more consistent with IFRS 2 compared to the current treatment required by paragraph 26.15 of the *IFRS for SMEs* Standard; and

    (b) cost-benefit reasons for mandating default treatment as cash-settled may no longer be valid among SMEs today and therefore the IASB should revisit the requirements of Section 26.

44. Some SMEIG members did not support the IASB amending Section 26 to require equity-settled rather than cash-settled as the default treatment because:

    (a) the difficulty for SMEs in accounting for share-based payment transactions as cash-settled is determining the fair value of shares. According to a SMEIG member, this problem cannot be solved by changing the default treatment. Instead changing the default treatment to equity-settled might increases difficulty.

    (b) equity settlement as the default treatment would not represent the substance of most arrangements. According to a SMEIG member, all share based payments are ultimately cash-settled (as the equity instruments are not tradeable) for

SMEs. SMEs generally adopt a mechanism whereby the shares are bought back by the entity or the recipient otherwise receives cash.

Staff analysis

45. In developing the *IFRS for SMEs* Standard, the IASB received feedback that the recognition and measurement of equity-settled share-based transactions prescribed by IFRS 2 was not sufficiently simple for SMEs.

46. As the IASB considered this feedback, further simplification were introduced into the *IFRS for SMEs* Standard for measurement of equity-settled share-based transactions, and cash-settled was made the default treatment instead of equity-settled when share-based payment transactions give either the entity or the counterparty a choice of settling the transaction in cash or transfer of equity.[4] The staff note that cash-settled was made the default treatment, instead of equity-settled, for share-based payment with settlement option for cost-benefit reasons.

47. The staff also note that FRS 102 was amended to align the requirements of Section 26 for share-based payment transactions with cash alternatives where the entity has the choice of settlement with the equivalent requirements of IFRS 2. Where the entity has a choice of settlement, FRS 102 requires share-based payment arrangements with cash alternatives to be accounted for as equity-settled share-based payment arrangements, unless the entity has a past practice or a stated policy of selling in cash, or generally settles in cash whenever the counter party asks for cash settlement; or the equity settlement option has no commercial substance. The requirements for share-based payment transactions with cash alternatives where the counterparty has the choice of settlement were also amended. FRS 102 requires these arrangements to be accounted for as wholly cash-settled share-based payments unless the cash settlement has no commercial substance. This simplifies the accounting for these arrangements compared to the equivalent requirements of IFRS 2.

[4] See paragraphs BC129–BC131 of the Basis for Conclusions on the *IFRS for SMEs* Standard

48. The table below summarises the requirements in accounting for share-based payments with settlement options in *IFRS for SMEs* Standard, IFRS 2 and FRS 102.

	IFRS for SMEs Standard	IFRS 2	FRS 102
Entity has settlement option	Accounted as cash-settled payments unless the entity has past practice of settling by equity or the cash settlement option has no commercial substance. (See paragraph 26.15 of *IFRS for SMEs* Standard)	Accounted as cash-settled if there is a present obligation to settle in cash. If there is no present obligation, then accounted as equity-settled. (See paragraphs 41–43 of IFRS 2)	Accounted as equity-settled unless the entity has past practice of settling in cash or the equity settlement option has no commercial substance (ie unless the entity has a present obligation to settle in cash). (See paragraph 26.15A of FRS 102)
Counterparty has settlement option		Accounted as a compound financial instrument. (See paragraph 35 of IFRS 2)	Accounted as cash-settled unless the cash settlement option has no commercial substance. (See paragraphs 26.15B and 26.15C of FRS 102)

49. In amending the requirements in the *IFRS for SMEs* Standard to require equity-settled as the default treatment rather than cash-settled, the staff note the IASB may consider several approaches such as:

(a) update paragraph 26.15 of the *IFRS for SMEs* Standard to require equity-settled as the default accounting treatment unless there are evidence to support cash-settled accounting—which requires the same accounting treatment whether the entity or counterparty has a settlement option.

(b) align paragraph 26.15 of the *IFRS for SMEs* Standard with IFRS 2—which requires a different accounting treatment depending on whether the entity or the counterparty has a choice of settlement.

(c) update paragraph 26.15 of the *IFRS for SMEs* Standard to account for share-based payment with settlement option similar to the simplification of

FRS 102—which requires a different accounting treatment depending on whether the entity or the counterparty has a choice of settlement.

50. Following the feedback from the SMEIG, the staff recommend amending paragraph 26.15 of the *IFRS for SMEs* Standard on share-based payments with settlement options to require equity-settled as the default treatment rather than cash-settled because:

(a) accounting for share-based payment transactions as cash-settled share-based payments may be onerous as it requires fair value to be determined each year;

(b) where the entity has no past practice of settling in cash, recognising a liability as required by paragraph 26.15 of the *IFRS for SMEs* Standard may be inconsistent with the definition of a liability set out by the *Conceptual Framework* and to be incorporated in the revised Section 2 of the *IFRS for SMEs* Standard; and

(c) some SMEIG members expressed support for the IASB to take further action, including reviewing the requirements in paragraph 26.15 of the *IFRS for SMEs* Standard.

51. The staff recommend the IASB develop and propose amendments to Section 26 of the *IFRS for SMEs* Standard for share-based payments with settlement options to require equity-settled as the default treatment rather than cash-settled.

52. If the IASB approves the staff's recommendation, the staff will bring a separate paper at a future IASB meeting to discuss the approach to amending paragraph 26.15 of the *IFRS for SMEs* Standard.

Staff recommendation and questions for the IASB

53. In the light of the staff analysis and SMEIG recommendations in paragraphs 14–52 of this paper, the staff recommend the IASB:

(a) propose amendments to Section 22 of the *IFRS for SMEs* Standard to remove paragraph 22.7(a) of the Standard;

(b) discuss in the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard, or supporting material to the Exposure Draft, the inconsistencies between the *IFRS for SMEs* Standard and the European Accounting Directive;

(c) propose amendments to Section 26 of the *IFRS for SMEs* Standard to include in Section 26 the scope exclusions similar to those in paragraph 5 of IFRS 2; and

(d) develop and propose amendments to Section 26 on share-based payments with settlement options to require equity-settled as the default treatment rather than cash-settled.

Questions for the IASB

Does the IASB agree with the staff recommendations in paragraph 53 of this paper to:

(a) propose amendments to Section 22 of the *IFRS for SMEs* Standard to remove paragraph 22.7(a) of the Standard;

(b) discuss in the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard, or supporting material to the Exposure Draft, the inconsistencies between the *IFRS for SMEs* Standard and the European Accounting Directive;

(c) propose amendments to Section 26 of the *IFRS for SMEs* Standard to include in Section 26 the scope exclusions similar to those in paragraph 5 of IFRS 2; and

(d) develop and propose amendments to Section 26 on share-based payments with settlement options to require equity-settled as the default treatment rather than cash-settled?