IASB® meeting

Date	**January 2024**
Project	**Second Comprehensive Review of the *IFRS for SMEs®* Accounting Standard**
Topic	**Reconciliation for liabilities arising from financing activities**
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Purpose of this paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to:

   (a) consider feedback on paragraph 7.19A of Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft), which proposes to require SMEs to disclose a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities; and

   (b) decide whether to make any changes to that paragraph.

2. In this paper, the term SMEs refers to entities that are eligible to apply the *IFRS for SMEs* Accounting Standard (the Standard).

Staff recommendation

3. The staff recommend the IASB finalises the disclosure requirement proposed in paragraph 7.19A of the Exposure Draft.

Structure of this paper

4. This paper is structured as follows:

   (a) development of the proposals (paragraphs 5–13);

   (b) proposals in the Exposure Draft (paragraphs 14–16);

   (c) feedback on the proposals in the Exposure Draft (paragraphs 17–18);

   (d) staff analysis (paragraphs 19–23); and

   (e) staff recommendation and question for the IASB (paragraph 24).

Development of the proposals

Disclosure Initiative (Amendments to IAS 7)

5. *Disclosure Initiative* (Amendments to IAS 7) added the following disclosure objective to IAS 7 *Statement of Cash Flows*:

> 44A An entity shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

6. Paragraphs 44B–44E of IAS 7 explain how to apply that disclosure objective. These paragraphs do not prescribe a specific format but specify that the entity could fulfil the disclosure objective by providing a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities.

7. Exposure Draft *Disclosure Initiative* (Proposed amendments to IAS 7) proposed to require a reconciliation of the amounts in the opening and closing statements of financial position for each item for which cash flows have been, or would be, classified as financing activities in the statement of cash flows, excluding equity items. However, financial institutions said this proposal would not provide relevant information to users of their financial statements because:

(a) the proposed reconciliation would not capture all sources of finance, namely customer deposits classified as operating cash flows; and

(b) regulatory disclosure requirements already provide disclosures about the financing structure of the entity.

8. The IASB agreed with the feedback from financial institutions. Therefore, in finalising the amendments to IAS 7, the Board decided not to require a reconciliation but noted a reconciliation is one way to fulfil the disclosure requirements.

Feedback on the Request for Information

9. The Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* (Request for Information) asked about how to align the *IFRS for SMEs* Accounting Standard (the Standard) with the individual amendments to full IFRS Accounting Standards in the scope of the review. The IASB asked for views on aligning the Standard with *Disclosure Initiative* (Amendments to IAS 7) because:

(a) users of SMEs' financial statements are particularly interested in information about liquidity and solvency; and

(b) the amendments would provide users of financial statements with an improved understanding of an entity's financing activities.

10. Many respondents to the Request for Information via comment letters and the online survey supported aligning the Standard with *Disclosure Initiative* (Amendments to IAS 7). However, a few respondents expressed concerns about the costs of the disclosure for SMEs. One respondent said the disclosure could be simplified in the Standard by prescribing the disclosures that would meet the disclosure objective.

11. 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.

Advice of the SME Implementation Group (SMEIG)

12. After considering the feedback on the Request for Information, in September 2021[1], the staff sought the advice of the SMEIG on the possibility of simplifying the requirements in *Disclosure Initiative* (Amendments to IAS 7) for SMEs by proposing to require SMEs to disclose a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. Therefore, an SME would not be required to satisfy the disclosures objective in *Disclosure Initiative* (Amendments to IAS 7), and so the SME 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.

13. SMEIG members generally agreed with the staff suggestion to simplify the requirements for SMEs (as specified in paragraph 12). However, one SMEIG member disagreed with aligning the Standard with this amendment. In the view of this member, the potential benefit of the information that would be disclosed to users of SME financial statements introduced by this amendment would not exceed the preparation costs for SMEs.

Proposals in the Exposure Draft

14. Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft) proposed SMEs disclose a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. The Exposure Draft did not include the disclosure objective from *Disclosure*

[1] September 2021 SMEIG meeting papers and meeting summary.

Initiative (Amendments to IAS 7). The Exposure Draft proposed the following requirement (paragraph 7.19A):

> 7.19A An entity shall disclose a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. Liabilities arising from financing activities are liabilities for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities. The reconciliation shall include:
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> (a) changes from financing cash flows;
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> (b) changes arising from obtaining or losing control of subsidiaries or other businesses;
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> (c) the effect of changes in foreign exchange rates;
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> (d) changes in fair values; and
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> (e) other changes.

15. In developing 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.

16. Furthermore, regarding excluding the disclosure objective for SMEs:

    (a) the *IFRS for SMEs* Accounting Standard generally does not include the disclosure objectives in full IFRS Accounting Standards because it reduces the specific disclosure requirements in IFRS Accounting Standards needed to satisfy those disclosure objectives using the principles in paragraph BC157 of the Basis for Conclusions of the Standard.

    (b) the scope of the *IFRS for SMEs* Accounting Standard excludes entities that hold assets in a fiduciary capacity for a broad group of outsiders as a primary business (which would exclude most banks and credit unions). Therefore, the feedback received from financial institutions on Exposure Draft *Disclosure Initiative* (Proposed amendments to IAS 7) (see paragraphs 7–8) is not relevant to SMEs.

Feedback on the proposals in the Exposure Draft

17. The Invitation to Comment in the Exposure Draft did not include a specific question on proposed paragraph 7.19A. However, Question 11 of the Invitation to Comment asked a general question whether respondents have any comments on other proposed amendments in the Exposure Draft.

18. Most respondents did not comment on paragraph 7.19A of the Exposure Draft. However, some respondents said the proposed disclosure requirement in paragraph 7.19A would cause unnecessary complexity for SMEs and only provide limited benefits for users. A few of these respondents said the reconciliation would not provide additional information about an entity's cash flows and liquidity, noting that most SMEs do not have complex financial liabilities with non-cash changes. One respondent said:

> We have reservations about the proposed disclosure in paragraph 7.19A which require a reconciliation for liabilities arising from financing activities. Information about gross amounts of cash paid or received for financing activities, and interest expenses are already required to be disclosed (paragraphs 7.6 and 7.10). Paragraph 11.42 in Section 11 also requires an entity to disclose information that would enable users to evaluate the significance of financial instruments for its financial position and performance, for example repayment schedule disclosure.
>
> The proposed reconciliation in paragraph 7.19A does not provide additional information about an entity's cash flows from financing activities and its liquidity. While this reconciliation is required in IAS 7, we do not support adding this disclosure requirement in this Standard for SMEs as the benefit to users of SME's financial statements is not clear and it appears to contradict simplicity in the Standard. (CL 25)

Staff analysis

19. User feedback during this comprehensive review indicates that the disclosure requirement in paragraph 7.19A of the Exposure Draft is relevant to SMEs.[2]

20. However, some respondents asserted that the proposed disclosure requirement in paragraph 7.19A would result in unnecessary costs for SMEs as the disclosure would provide limited benefits for users (that is, they question whether the proposed requirement meets the cost-benefit assessment). These respondents did not suggest ways that the IASB might further simplify paragraph 7.19A, but rather they suggested the paragraph be removed. Given this feedback, the staff think the IASB only needs to consider the following two approaches (that is, the IASB does not need to redeliberate 'how' to align the Standard with *Disclosure Initiative* (Amendments to IAS 7)):

    (a) alternative one: finalise the proposed paragraph 7.19A as drafted; and

    (b) alternative two: delete the proposed paragraph 7.19A based on cost-benefits assessment.

21. The staff observe that feedback on the Exposure Draft is generally consistent with feedback on the Request for Information—that is some respondents think the cost of the proposed disclosure for SMEs would not exceed the benefits for users.

22. However, most respondents did not comment on paragraph 7.19A of the Exposure Draft, indicating that they do not have similar concerns. Furthermore, most respondents to the user survey and those users interviewed supported requiring a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. This feedback indicates that the requirement in paragraph 7.19A would provide more than limited benefits to users and therefore would not result in unnecessary costs for SMEs.

[2] 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 *IFRS for SMEs* Accounting Standard. See paragraph 30 of the Basis for Conclusions on the Exposure Draft.

23. Overall, the staff think that feedback on the Exposure Draft supports finalising the proposed paragraph 7.19A. The staff continue to support the IASB's rationale for including paragraph 7.19A in the Exposure Draft (see paragraph 15) and note:

   (a) users of SMEs' financial statements are particularly interested in information about liquidity and solvency (one of the principles for reducing disclosures in paragraph BC157 of the Basis for Conclusions on the 2015 Standard); and

   (b) although SMEs generally do not have complex transactions, the proposed disclosure requirement in paragraph 7.19A would provide users of financial statements with an improved understanding of an entity's financing activities, particularly when SMEs have financing arrangements other than a simple bank loan, for example SME lessees in finance leases.

Staff recommendation and question for the IASB

24. The staff recommend the IASB finalises the disclosure requirement proposed in paragraph 7.19A of the Exposure Draft.

Question for the IASB
Does the IASB agree with the staff recommendation to finalise the disclosure requirement proposed in paragraph 7.19A of the Exposure Draft?