
IASB[®] meeting

Date	March 2024
Project	Second Comprehensive Review of the <i>IFRS for SMEs</i>[®] Accounting Standard
Topic	Proposed revised Section 2 <i>Concepts and Pervasive Principles</i>
Contacts	Helen Lloyd (hlloyd@ifrs.org)

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS[®] Accounting Standards or the *IFRS for SMEs*[®] Accounting Standard. The IASB's technical decisions are made in public and are reported in the IASB[®] *Update*.

Introduction and purpose of the paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to:
 - (a) consider feedback on the proposals to reflect the principles of the Conceptual Framework for Financial Reporting in Section 2 *Concepts and Pervasive Principles* in the Exposure Draft *Third edition of the IFRS for SMEs Accounting Standard* (Exposure Draft); and
 - (b) decide whether to amend proposals in Section 2 of the *IFRS for SMEs Accounting Standard* (the Standard).
2. In this paper, the term SMEs refers to entities that are eligible to apply the Standard.

Structure of the paper

3. This paper is structured as follows:
 - (a) staff recommendation (paragraph 4);
 - (b) background (paragraphs 5–10);
 - (c) feedback from comment letters (paragraphs 11–16);

- (d) staff analysis (paragraphs 17–33);
- (e) staff recommendation and question for the IASB (paragraph 34); and
- (f) Appendix—extract from the Basis for Conclusions accompanying the Exposure Draft.

Staff recommendation

4. The staff recommend the IASB proceed with the proposals in Section 2 of the Exposure Draft and make changes to these proposals only to improve drafting.

Background

Section 2 requirements relating to concepts and pervasive principles

5. Section 2 *Concepts and Pervasive Principles* of the Standard is based on the 1989 *Framework for the Preparation and Presentation of Financial Statements* (1989 Framework), which was current when the *IFRS for SMEs Accounting Standard* was issued.
6. In 2018 the IASB issued its new *Conceptual Framework for Financial Reporting* (2018 Conceptual Framework) which replaced the 1989 Framework and has since then been used for the development of full IFRS Accounting Standards. The 2018 Conceptual Framework is not itself an IFRS Accounting Standard. This is an important point of difference from the *IFRS for SMEs Accounting Standard*: as expressed in BC41 of the Exposure Draft, “Section 2 is part of the Standard meaning that it has equal authority with other sections in the Standard”.

Feedback on the 2020 Request for Information

7. In January 2020, the IASB published Request for Information *Comprehensive Review of the IFRS for SMEs Standard* (2020 Request for Information) as a first step in its second comprehensive review.
8. Many respondents to the 2020 Request for Information agreed that Section 2 should be aligned with the Conceptual Framework on the grounds that the *IFRS for SMEs Accounting Standard* should use the same framework as full IFRS Accounting Standards. Furthermore, many respondents also supported retaining the undue cost or effort exemption that is included in Section 2.

Question in the Exposure Draft

9. Given the feedback on the 2020 Request for Information, at its May 2021 meeting¹, the IASB discussed its approach to alignment with the 2018 *Conceptual Framework*, looking in particular at:
 - (a) Revising Section 2 to be closely aligned with the contents of the 2018 *Conceptual Framework* and to include an override paragraph to emphasise that the specific requirements of the other sections of the *IFRS for SMEs Accounting Standard* take precedence over the requirements in Section 2;
 - (b) Retaining the status of section 2 as part of the Standard;
 - (c) Retaining the concept of undue cost or effort;
 - (d) Reviewing the revised Section 2 before issuing the Exposure Draft, to address any inconsistencies with other sections that had arisen in the drafting process.

¹ See [AP30B: Towards an Exposure Draft—2018 Conceptual Framework \(ifrs.org\)](#) of the May 2021 meeting

The IASB performed the review in paragraph 9(d) in its May 2022 meeting². Inconsistencies with other sections were observed in a number of areas where amendments were not considered necessary.

10. The IASB noted one topic that required attention in two sections of the Standard. Section 21 *Provisions and Contingencies* and Section 18 *Intangible Assets other than Goodwill*, which are based on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 38 *Intangible Assets* respectively, use the definition of a liability and an asset from the 1989 Framework not the 2018 *Conceptual Framework*. Aligning Section 2 with the 2018 *Conceptual Framework* would therefore lead to an inconsistency with these other sections of the Standard. In the Exposure Draft, the IASB proposed to leave the definitions in these sections based on the 1989 Framework, with a footnote explaining the inconsistency and reproducing the Framework's definitions so that the relevant definitions for these sections alone would be applied. This proposed approach is consistent with how the inconsistencies are treated in IAS 37 and IAS 38. The IASB also agreed to ask a specific question in the Invitation to Comment to elicit views on this matter.

Feedback from comment letters

11. The questions asked in the Invitation to Comment (relating to Section 2 of the Standard) are reproduced below, each followed by a summary of the feedback received:

Question 2(i)

Do you have comments or suggestions on the revised Section 2? Please explain the reasons for your suggestions.

² See [AP30C: Towards an Exposure Draft—Review for inconsistencies between revised Section 2 and other Sections of the IFRS for SMEs Accounting Standard](#) of the May 2022 meeting

-
12. Almost all respondents that responded to Question 2(i) supported the proposal to align Section 2 of the Standard with the 2018 *Conceptual Framework*. Approximately half of these respondents expressed support for the proposed revised Section 2 and did not provide any further comments, whereas the other respondents provided comments and suggestions.
13. Respondents provided the following main comments or suggestions on proposed revised Section 2:
- (a) undue cost or effort—some respondents provided comments on the retention of the undue cost or effort concept. Most of these respondents supported retaining the concept because it keeps the Standard simple and ensures the costs of complying with the requirements do not outweigh the benefits. Contrastingly, a few of these respondents were not supportive of the concept because it causes tension between entities, auditors and national standard-setters due to the judgement involved in applying the concept.
 - (b) length of Section 2—a few respondents said the proposed revised Section 2 is too long, though only one suggested paragraphs that could be removed, based on the idea of using the corresponding section of FRS 102, the equivalent UK and Republic of Ireland Standard.
 - (c) status of Section 2—a few respondents commented on the status of Section 2. Most of these few respondents suggested the IASB reconsiders the inclusion of Section 2 in the Standard, and requested a change so its status is similar to the 2018 *Conceptual Framework's* relationship with full IFRS Accounting Standards.
 - (d) precedence of other sections—a few respondents commented on the proposal in paragraph 2.2 of the Exposure Draft, which states that the requirements in other sections take precedence over Section 2. These respondents agreed and said that this principle will enhance consistency in applying the requirements.

- (e) language—a few respondents provided suggestions to improve the wording in Section 2. A few said that the language used in the revised Section 2 is highly technical and difficult to understand but did not provide specific examples.

Question 2(ii)

Do you agree that Section 18 and Section 21 should continue to use the definition of an asset and of a liability from the previous version of Section 2 (based on the 1989 *Framework*)?

14. Most respondents that responded to Question 2(ii) agreed with the proposal for Sections 18 and 21 to continue to use the definition of an asset and a liability from the 1989 Framework (as used in the previous version of Section 2). These respondents agreed because this proposal is consistent with full IFRS Accounting Standards.
15. Many respondents conditionally agreed with the proposal providing the following suggestions:
 - (a) full IFRS Accounting Standards consistency—a few respondents suggested that the definition of an asset and a liability in Sections 18 and 21, respectively, should be updated when the corresponding definitions in IAS 38 and IAS 37 are updated.
 - (b) structure—a few respondents suggested that the definitions should be given prominence in both Sections 18 and 21. This could be achieved by including the definition of a liability into the body of Section 21 instead of as a footnote.
 - (c) clarification—a few respondents suggested that the IASB clarifies that the recognition and measurement requirements in Sections 18 and 21 are unchanged.
16. Some respondents disagreed with the proposal, providing the following reasons:

-
- (a) confusion—a few respondents explained that having to deal with two separate definitions for assets and liabilities can be confusing for preparers and users of SMEs' financial statements.
 - (b) pervasiveness of Section 2—a few respondents explained that as the whole Standard is under review, Section 2 should be pervasive and its concepts and principles should be reflected consistently in all sections of the Standard.
 - (c) a few respondents suggested the IASB considers extending the use of the definitions of an asset and of a liability from the previous version of Section 2 (based on the 1989 Framework) to Section 20 *Leases* of the Exposure Draft. This was suggested because IFRS 16 *Leases* refers to the definition in the 2018 Conceptual Framework and Section 20 has not been aligned with IFRS 16, and therefore requiring SMEs to apply the revised definitions proposed in Section 2 to Section 20 may have unintended consequences.

Staff analysis

- 17. The staff analysis is set out as follows:
 - (a) application of the alignment approach (paragraphs 18–22 of this paper);
 - (b) status of the section (paragraph 23 of this paper);
 - (c) use of undue cost or effort (paragraphs 24–25 of this paper);
 - (d) language (paragraphs 26–27 of this paper);
 - (e) definitions of assets and liabilities (paragraphs 28–32 of this paper); and
 - (f) length of the section (paragraph 33 of this paper).

Application of the alignment approach

- 18. The alignment approach treats alignment with full IFRS Accounting Standards as the starting point for developing the *IFRS for SMEs* Accounting Standard, and applies the principles of relevance to SMEs, simplicity and faithful representation, including the

assessment of costs and benefits, in determining whether and how that alignment should take place. The IASB applies the alignment approach to each new or revised IFRS Accounting Standard within the scope of the review.

19. The proposals in the Exposure Draft applied this approach to Section 2 of the Standard by fully rewriting the section to be based on the 2018 *Conceptual Framework*.

Assessment of relevance to SMEs

20. The Standard could not function without a framework of concepts and principles, so Section 2 as a whole is fundamental to the Standard. All topics from the 2018 *Conceptual Framework* are addressed – albeit condensed and simplified – in Section 2 since they relate to underlying concepts and do not set out requirements for a transaction or event. Feedback on the section’s length is discussed further in paragraph 33 of this paper.

Assessment of simplicity and cost-benefit

21. The staff recommendation is only for minor drafting changes to the proposed revised Section 2, so our assessment of simplicity and cost-benefit is the same as for the Exposure Draft. In particular, retaining the undue cost or effort exemption (see paragraphs 24–25 of this paper) will support continuing simplicity and should, by definition, keep costs to preparers proportionate.

Assessment of faithful representation

22. The principle of faithful representation is discussed in Section 2: this means that by definition the section assists preparers with achieving faithful representation. Paragraph BC49 of the Exposure Draft (reproduced in the Appendix to this paper) explains the difference between reliability and faithful representation.

Status of the section

23. Only a few respondents disagreed with the proposal to retain Section 2 as part of the Standard and of equal status to other sections. In the staff's view, the key risk associated with this equal status is that difficulties arise if there are conflicts between Section 2 and other sections. However in the staff's view this risk is addressed by the inclusion of paragraph 2.2 of the Exposure Draft that explains the decision process when there are inconsistencies between the concepts and principles in Section 2 and the requirements in another section of the Standard. Given this paragraph, the staff think maintaining the current status of Section 2, which was supported by most respondents, is the most reasonable approach.

Use of undue cost or effort

24. The availability of the undue cost or effort exemption in carefully selected parts of the Standard has enabled a balance between good drafting, consistent with IFRS Accounting Standards, and usability for SMEs. If the exemption were no longer available then in a number of places in the Standard the IASB would be left with a choice between making the requirements either more complex (by simply removing the exemption) or less well-defined (by introducing further accounting policy choices, thus reducing consistency between SMEs and potentially devaluing the Standard).
25. In the staff's view, therefore, the undue cost or effort exemption should remain and it should be as clear as possible in Section 2 that it only applies where specifically indicated in other sections of the Standard, rather than being generally available for entities to choose. The IASB can then continue to review potential amendments in future reviews of the Standard and to decide in each case whether a new undue cost or effort exemption should be offered.

Language

26. As feedback generally supported or did not disagree with the language used in Section 2, the staff recommend not making substantial changes but reviewing for clarity and making drafting changes where this appears helpful.
27. The fact that Section 2 is pervasive to the remainder of the Standard, describing the terms and principles used in other sections, means that there are cases where technical language is unavoidable; however using technical terms clearly in Section 2, and including all appropriate definitions and explanations, means that the other sections in the Standard can continue to use simple language because the underlying concepts and pervasive principles are clearly described in Section 2.

Definitions of assets and liabilities

28. The general support from respondents for the proposal in the Exposure Draft on the definitions of assets and liabilities provides evidence to continue to use the 1989 Framework definitions in Sections 18 and 21.
29. The suggestion by respondents to update the definitions by amending as and when IAS 37 and IAS 38 are updated would be incorporated as part of the maintenance approach to the Standard. In other words, in the comprehensive review that followed any such change to IAS 37 or IAS 38, these changes would be considered along with any others.
30. The possibility of incorporating the definitions into the text rather than as footnotes was considered carefully in the drafting of the Exposure Draft. In the staff's view, using a footnote presentation gives clarity without interrupting the flow of the section and with a reduced risk of confusion about whether this separate definition is relevant. It also maintains consistency with the way that this is dealt with in IAS 37 and IAS 38.
31. In respect of adding a similar note to Section 20 *Leases*, as suggested by some respondents, Section 20 is based on IAS 17 not on IFRS 16. IAS 17 was not amended by the Conceptual Framework to include the explanatory footnotes, and neither was

IFRS 16 which brought in the requirements for lessors unchanged from IAS 17. Adding footnotes would therefore introduce an inconsistency with full IFRS Accounting Standards in respect of lessor accounting.

32. The conceptual basis for the continuing use of assets and liabilities in lessor accounting in IFRS 16 in the light of the definitions in the Conceptual Framework is explained in the Basis for Conclusions to IFRS 16. These discussions demonstrate that a simple footnote explanation would be insufficient, and therefore in the staff's view it would be inappropriate to add footnotes to Section 20.

Length of the section

33. Respondents' concerns about the section being too long are linked with concerns on complexity of language discussed in paragraphs 26-27 of this paper. The section is already much shorter than the 2018 *Conceptual Framework* and, in the staff's view, any further reductions in length would not be possible without removing content that is crucial. To remain a stand-alone standard, the Standard needs to include a self-contained set of concepts and principles so that SMEs do not have to look outside the Standard (although this is still allowed for in the hierarchy set out in paragraph 10.5 of the Exposure Draft).

Staff recommendation and question for the IASB

34. The staff recommend the IASB proceed with the proposals in Section 2 of the Exposure Draft and make changes to these proposals only to improve drafting—and therefore do not make changes to the definitions of assets and liabilities or to the availability of the undue cost or effort exemption.

Question for the IASB

Does the IASB agree with the staff recommendation in paragraph 34 of this paper to proceed with the proposals in Section 2 of the Exposure Draft and make changes to the proposals only to improve drafting?

Appendix—extract from the Basis for Conclusions accompanying the Exposure Draft

The following extract summarises the considerations of the IASB when developing the proposed revised 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’.³

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

³ 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.

is aligned with the 2018 *Conceptual Framework*. The IASB did not apply the alignment principles to Section 2, because the alignment principles are not 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.

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.