



## REQUEST FOR INFORMATION: COMPREHENSIVE REVIEW OF THE IFRS FOR SMEs STANDARD

Issued 3 November 2020

ICAEW welcomes the opportunity to comment on the Request for Information: Comprehensive Review of the IFRS for SMEs Standard published by IASB on 28 January 2020, a copy of which is available from this [link](#).

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## KEY POINTS

### SUPPORT FOR REQUEST FOR INFORMATION

1. ICAEW welcomes the comprehensive review of the IFRS for SMEs and the opportunity to input into the IASB's considerations as to whether and how to amend the IFRS for SMEs to take account of changes to full IFRS. We support the IASB's continued work in reviewing and developing the IFRS for SMEs to ensure that it provides users of SME financial statements with relevant information, while balancing the costs and benefits for preparers of providing that information.

### OVERALL APPROACH TO ALIGNMENT

2. We consider that there should be a rebuttable presumption that the IFRS for SMEs is aligned with full IFRS unless, based on an analysis of the costs and benefits to SMEs and the needs of users of SME accounts, there are clear grounds for not doing so. We believe that an approach that starts with alignment with full IFRS has the advantage of being able to leverage the cost-benefit analysis already performed for, and experience gained from implementation of, full IFRS. Taking this body of evidence and factoring in specific costs and benefits relating to SMEs should provide invaluable information to help inform the IASB's decisions on aligning the IFRS for SMEs with the requirements in the relevant full IFRS.
3. We are supportive of aligning the principles and important definitions in full IFRS with the IFRS for SMEs but also believe that where wording is included from the full IFRS, it is preferable to use the exact same language. This avoids the need for SMEs (and their advisors) to try to decide if there is a significance to the changed language. This is not to say that we want the IASB to retain the precise wording of all requirements of the full IFRS. Rather we would want the IASB to consider the principles of relevance, simplicity and faithful representation included in the Request for Information, as well as the costs and benefits to SMEs and the needs of users of SME accounts.
4. In our response to ED 2013/9, we urged the IASB to set out a clearer set of principles for determining whether the IFRS for SMEs should be amended in light of a new or revised standard being published. We support the principles of relevance, simplicity and faithful representation but we believe there is scope to include more context to aid their application.
5. The principle of relevance is important, and the Request for Information rightly focuses on whether the problem addressed by an IFRS would make a difference in the decisions of users of financial statements prepared under the IFRS for SMEs. It does not, however, provide a framework by which this can be judged. Users of SME accounts are likely to be less sophisticated than users of accounts prepared under full IFRS and key considerations would include the extent to which they would recognise and understand the information in the accounts that have been prepared and whether the information required to be disclosed is that which is most relevant to users.
6. We believe that the faithful representation test should be a final (catch all) test that is applied after the principles of relevance and simplicity have been met, to determine whether to align or not. If this is what is intended in the Request for Information, then this needs to be clearer.
7. In relation to simplicity, the Request for Information indicates that this is based on an assessment of what simplifications are 'appropriate' but there is no indication of how this might be measured. We believe that an important consideration would be a comparison of the costs and benefits for preparers of SME accounts, bearing in mind the primary user and preparer for many SMEs are often one and the same.

### ALIGNMENT WITH IFRS 9, 15 AND 16

8. Our responses to the questions in Part B of the Request for Information are restricted to those focusing on possible alignment with IFRS 9, IFRS 15 and IFRS 16. The questions in Part B are very specific and it would have been helpful if the explanatory material in relation

to the IASB's thinking on aligning specific sections of the IFRS for SMEs with full IFRS (as set out in Appendix B of the Request for Information) had been given more prominence in the paper.

9. Except where noted in our responses to the questions posed, we are generally supportive of aligning the IFRS for SMEs with these three new IFRSs, with appropriate simplifications, similar in nature to the type of simplifications applied to full IFRS in order to create the IFRS for SMEs in the first place. We support shortening the material as much as possible, but advise against changes to definitions, language or terminology.

## TRANSITION AND COMPARATIVES

10. The Request for Information does not seek views on the approach to transition for amendments to the IFRS for SMEs. Appendix A of the IFRS for SMEs includes requirements on transition and, with a few exceptions, requires amendments to the Standard to be applied retrospectively and comparatives to be restated in line with Section 10. Given that IFRS 9, IFRS 16 and IFRS 15 have all introduced the concept of a simplified transition methodology (albeit with different terminology), with no requirement to apply the new measurement retrospectively, we do not consider that it would be appropriate or fair to make the application of new requirements in the IFRS for SMEs in these areas more complicated for SMEs than for full IFRS reporters.
11. We therefore believe that the IASB should import the main principles of the transition rules from the three IFRSs into the IFRS for SMEs, in so far as they would be relevant and proportionate to SMEs. In doing this, we would urge the IASB to adopt one approach and one set of terminology to apply to all three standards.

## OTHER CONSIDERATIONS: 2017 UK TRIENNIAL REVIEW AMENDMENTS

12. We would encourage the IASB to consider whether any of the [2017 Triennial Review amendments](#) made to FRS 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland, might also be relevant to the IFRS for SMEs. In particular, we would most strongly recommend the simplification introduced into Section 11 *Basic Financial Instruments* to allow small entities the option to measure loans from a director (or their group of close family members when that group contains at least one shareholder) at transaction price, rather than present value. The IASB could review the rest of the Triennial Review amendments to see if any others might be helpful to the IFRS for SME's user base.

## ANSWERS TO SPECIFIC QUESTIONS

### PART A – strategic and general questions

#### Alignment approach

**Question G1A. In your view, should the IFRS for SMEs Standard be aligned with full IFRS Standards? Please explain why you are suggesting the IFRS for SMEs Standard should or should not be aligned with full IFRS Standards.**

13. We believe that there should be a rebuttable presumption that the IFRS for SMEs will be aligned with full IFRS. This presumption may be rebutted where there are clear grounds for doing so which are based on an analysis of the costs and benefits to SMEs and the needs of users of SME accounts. For example, one potential reason why alignment might not be considered appropriate is where there would be significant effort on the part of SMEs in complying with the relevant requirements, with little or no value to users.
14. An approach that starts with alignment with full IFRS has the advantage of being able to leverage the cost/benefit analysis already performed for the full standard and the experience gained from implementation of the full IFRS. Taking this body of evidence and factoring in specific costs and benefits relating to SMEs would, we believe, provide invaluable

information to help inform the IASB's decisions on aligning the IFRS for SMEs with the requirements in the full IFRS.

15. Another important factor in favour of full alignment is the fact that fast growing entities which start out using the IFRS for SMEs and then subsequently transition to full IFRS will encounter fewer barriers to change from an accounting perspective. This can be particularly important where, for example, profit before tax (or some alternative performance measure such as EBITDA) features in a bank covenant, or perhaps even more relevantly for the current scenario, there is a profit based bonus payable to senior personnel, and the profit would be different under the IFRS for SMEs and full IFRS.

**Question G1B. What extent of alignment of the IFRS for SMEs Standard with full IFRS Standards do you consider most useful, and why?**

**(a) Alignment of principles;**

**(b) Alignment of both principles and important definitions; or**

**(c) Alignment of principles, important definitions and the precise wording of requirements?**

**Please explain the reasoning that supports your choice of (a), (b) or (c).**

16. We are certainly supportive of aligning the principles and important definitions as set out in (b) above, but we also believe that where wording is included from the full IFRS standard, it is preferable to use the exact same language. This avoids the need for SMEs (and their advisors) to try to decide if there is a significance to the changed language. This is not the same as point (c), because we would not wish the IASB to retain the precise wording of all requirements of the full standard. This would clearly be impractical and result in an IFRS for SMEs being unnecessarily lengthy. Rather we would want to see consideration of the relevance, simplicity and faithful representation factors as already set out in the Request for Information, as well as consideration of the costs and benefits to SMEs and the needs of users of SME accounts.
17. As above, we believe a full IFRS standard should not be imported verbatim. The approach which currently characterises the IFRS for SMEs should continue to apply, such as excluding any non-core guidance, explanatory material or examples and keeping disclosure requirements to the minimum. An example of this non-core guidance can be seen in the financing component provisions of IFRS 15 (paragraphs 60 to 65). These provisions will seldom apply to SMEs but, if they did apply, they could easily be inferred by following simple discounting principles that recognise the time value of money. An example of explanatory material that could be omitted is paragraphs B14 to B19 of IFRS 15 on output and input methods. There will also be some core provisions in full IFRS that are complex, and less relevant to SMEs, which might be omitted altogether. For example, the derecognition guidance on continuing involvement in transferred assets in paragraphs 3.2.16 to 3.2.21 of IFRS 9.

**Alignment principles**

**Question G2. In your view, do these principles provide a framework to assist in determining whether and how the IFRS for SMEs Standard should be aligned with full IFRS Standards?**

18. We agree that it is important to have a clear set of principles for determining whether the IFRS for SMEs should be amended in light of a new or revised IFRS Standard. While we accept the overarching principles of relevance, simplicity and faithful representation, we believe there is scope to include more context which would aid their application.
19. The principle of relevance to SMEs is important. The Request for Information rightly focuses on whether the problem addressed by an IFRS Standard would make a difference in the decisions of users of financial statements prepared under the IFRS for SMEs but it does not include a framework by which this can be judged. Users of SME accounts are likely to be less sophisticated than users of accounts prepared under full IFRS and key considerations would include the extent to which they would recognise and understand the information in the

accounts that have been prepared and whether the information required to be disclosed is that which is most relevant to users.

20. It is also not clear whether the three principles will have to be applied in the order that they appear, and therefore are conditional on the previous one being fulfilled. Paragraph 35 seems to suggest that this is what is envisaged but the Request for Information does not specifically state this. We believe that the faithful representation test should be a final (catch all) test that is applied in determining alignment when the principles of relevance and simplicity have been met. If this is what is intended, then this needs to be made clear.
21. In terms of simplicity, the Request for Information indicates that applying the principle of simplicity involves looking at the IFRS and assessing what simplifications are appropriate. It is not clear how this appropriateness might be measured. For instance, the Request for Information makes no reference to considering the costs and benefits for preparers of SME accounts, which we believe is an important consideration.

### When to consider alignment

**Question G3. Three possible dates for when to consider alignment are discussed in paragraphs 38-40 of this part of the Request for Information. Which, if any, of these possible dates do you prefer? Those IFRS Standards, amendments to IFRS Standards or IFRIC Interpretations:**

- (a) Issued up to the publication date of the Request for Information;**
- (b) Effective before the publication date of the Request for Information;**
- (c) Effective and on which the post-implementation review was completed before the publication date of the Request for Information; or**
- (d) Issued or effective on some other date (please specify).**

**Please explain the reasoning that supports your views, for example, the benefits of the date selected.**

22. We believe that the IASB needs to take sufficient time to gather evidence, and use the experience gained from application of full IFRS when considering alignment in the IFRS for SMEs. This is particularly important when there have been major changes to standards.
23. It would seem likely that sufficient evidence would be available where full IFRS have been effective for two reporting periods. This would enable the IASB to draw on experiences in applying the requirements in full IFRS, gain evidence relating to their value to users of accounts, as well as ensuring that any further implementation challenges arising in the second year of reporting have been fully identified. This is not to say that the IASB should not start discussions in advance of this, but that the discussions might continue to be shaped by experiences over the first two reporting periods of application of the new standard. While we recognise the value of post-implementation reviews in sharing experiences and highlighting issues, these can take a considerable time to complete and where there is sufficient evidence already available, we do not believe the IASB needs to wait for the review.
24. We also acknowledge that there could be circumstances where the IASB determines that alignment is needed more quickly than two reporting periods, where this will be of benefit to SMEs. Given this, we would be wary of introducing prescriptive rules relating to timeframes on alignment as they might then inhibit the ability of the IASB to be flexible and responsive. That said, we do believe that it is important to maintain a stable platform for SME accounting and while incremental improvements might be helpful, we would not support the introduction of major changes more frequently than in a three year review cycle.

## **PART B – questions on aligning specific section of the IFRS for SMEs Standard**

### **Aligning Section 11 Basic Financial Instruments and Section 12 Other Financial Instrument Issues of the IFRS for SMEs Standard with IFRS 9 Financial Instruments**

#### **Question S3A. What are your views on supplementing the list of examples in Section 11 with a principle for classifying financial assets based on their contractual cashflow characteristics?**

25. The questions in Part B, particularly S3A to S3D, are very specific. To answer them requires stepping back and considering the requirements as a whole and their objectives and understanding the IASB's rationale for such an approach. In our view, the IASB's considerations and rationale set out in Appendix B of the Request for Information deserve greater prominence.
26. We are in favour of bringing in changes introduced by IFRS 9, but only those that are relevant, and deliver clear improvements, to accounting by SMEs.
27. We are supportive of adding a principle for classifying financial assets based on their contractual cashflow characteristics to the list of examples in Section 11 and simplifying the classification and measurement by taking away the business model overlay. We think this will give greater clarity in relation to measurement requirements for those debt instruments that are solely payments of principal and interest.
28. The vast majority of SMEs are likely to have financial assets within the scope of Section 11. In circumstances where SMEs have less straight forward financial instruments, then the requirements will be more challenging for them to apply and additional support and guidance for SMEs might be needed to aid implementation.

### **Impairment of financial assets**

#### **Question S3B. What is your view on aligning the IFRS for SMEs Standard with the simplified approach to the impairment of financial assets in IFRS 9?**

29. We agree that the full expected credit loss model for impairment would not be relevant to most SMEs applying the IFRS for SMEs and we are generally supportive of aligning the IFRS for SMEs with the simplified approach in IFRS 9. We consider, however, that for intercompany balances and loans to directors or participators, the IFRS for SMEs should offer preparers of SME accounts a choice of either the simplified approach in IFRS 9 or the current approach to impairment in Section 11 of the extant IFRS for SMEs as this would better reflect cost and benefit considerations.

### **Hedge accounting**

#### **Question S3C.**

- (a) **Do you consider Section 12 needs to include requirements on hedge accounting?**
- (b) **If your answer is yes, what are your views on retaining the current requirements to address the needs of entities applying the Standard, rather than aligning Section 12 with IFRS 9?**
- (c) **If your answer is no, please explain the reasons for your answer.**

30. While hedge accounting might not be commonly used by SME trading entities, we consider that Section 12 should continue to include requirements on hedge accounting for those preparers that do want to use them. We believe that Section 12 should be aligned with IFRS 9 but simplified in order to ensure that hedge accounting is easier to apply for SMEs. In this respect, the IASB might wish to consider the requirements set out in Section 12 *Other Financial Instrument Issues* of IFRS 102, which include simpler qualifying conditions without a requirement for a quantitative assessment of hedge effectiveness.

## Using recognition and measurement requirements in IFRS Standards for financial instruments

### **Question S3D.**

- (a) **Are you aware of entities that opt to apply the recognition and measurement requirements of IAS 39 with the disclosure requirements of Sections 11 and 12?**
- (b) **What are your views on changing the reference to IAS 39 to permit an entity to apply the recognition and measurement requirements of IFRS 9 and the disclosure requirements of Section 11 and 12?**

31. We agree that SMEs should be given the choice of applying the requirements of Sections 11 and 12 of the IFRS for SMEs in full or the recognition and measurement requirements of IFRS 9 and the disclosure requirements of Sections 11 and 12.

## Aligning Section 20 Leases of the IFRS for SMEs Standard with IFRS 16 Leases

### **Question S6. What are your views on aligning Section 20 with IFRS 16, making the simplifications listed in paragraphs (a) – (c)?**

32. The simplifications outlined in paragraphs (a) to (c) are explained in more detail in paragraph B71 of the Request for Information and our comments below therefore refer to this paragraph. We support alignment of Section 20 with IFRS 16 with some – but not all – of the simplifications listed in paragraph B71. In relation to paragraph B71(a), we support an option in the IFRS for SMEs to use a different discount rate if the interest rate implicit in the lease and the lessee's incremental borrowing rate cannot be readily determined. We believe the use of the market yield on high-quality corporate bonds would be a suitable proxy but that there may be another more appropriate measure given the specific circumstances. We therefore believe that this proxy should be a rebuttable presumption unless a more appropriate measure can be justified.
33. We do not support inclusion of the simplification in paragraph B71(b) which introduces a change to the definition of 'lease term'. In our view, this would not only make the standard inconsistent with IFRS 16 but it would also introduce an additional layer of complexity for SMEs and create confusion. Our response to question G1(c) indicates our support for retaining important definitions and principles and cautions against the use of different language in the IFRS for SMEs to full IFRS. This approach also appears to be out of line with the IASB's overall approach to aligning the IFRS for SMEs with full IFRS as set out in paragraph 30 and G1 of the Request for Information, which refer to aligning the principles in the IFRS for SMEs with those in full IFRS and using full IFRS as the starting point.
34. We are supportive of the simplification in paragraph B71(c) in relation to subsequent remeasurement of a lease liability as it addresses an area that can sometimes create complex practical issues. In relation to paragraph B71(d), we would support retaining the existing finance lease disclosures in the IFRS for SMEs but believe that these disclosures should be augmented in circumstances where further disclosures might be necessary, for instance reconciling disclosures on transition and in relation to lease payments for assets/liabilities that are not recognised in the balance sheet.
35. It is difficult to comment on whether we would support simplifications to the language (B71(e)) without seeing what those simplifications might be. However, as noted above, we do have reservations about introducing new and unfamiliar terminology to the IFRS for SMEs which could lead to implementation challenges and, as a result, inconsistencies in approach.
36. Some SMEs may be concerned that alignment of the IFRS for SMEs with IFRS 16 might introduce more complexity to lease accounting in SMEs. However, we believe that, with appropriate simplifications, the requirements would not be overly complex for the majority of SMEs. They would then be consistent with full IFRS and, we believe, provide better information to users.
37. The Request for Information does not address possible transitional arrangements for applying these amendments. The current rules on transition as set out in Appendix A to the IFRS for SMEs require, with a few exceptions, SMEs to apply amendments retrospectively

which would mean a need to restate comparatives. If such an approach is taken it would mean that SMEs would be facing more stringent transitional requirements than those adopting IFRS 16 for the first time, which does not seem appropriate or fair. We would strongly recommend, therefore, that the IFRS for SMEs imports the main principles of the transition rules that are applicable to first time adopters of IFRS 16.

### **Aligning Section 23 Revenue of the IFRS for SMEs with IFRS 15 Revenue from Contracts with Customers**

#### **Question S7A. Which of the three alternatives do you prefer for amending Section 23 to align with IFRS 15? Why have you chosen this alternative?**

38. The Request for Information refers to the replacement of IAS 18 with IFRS 15 but makes no mention of the significant change introduced with the replacement of IAS 11 with IFRS 15.
39. On balance, we support alternative 2. Our responses to questions G1 (c) and S6 above caution against the use of different language in the IFRS for SMEs to full IFRS. Reflecting the principles and language used in IFRS 15 in the IFRS for SMEs would ensure consistency of approach and avoids the operation of two different models of revenue recognition.
40. Concerns have been expressed, however, that many SMEs could find that, in applying the principles of IFRS 15, they would have to do significantly more work only to achieve the same or similar outcomes as before. Given these concerns, we believe that the IASB should consider a fresh approach that, firstly, only required SMEs to apply the new principles and definitions in the IFRS for SMEs to new contracts, without the need for retrospective application and, secondly, retains the principles of IFRS 15, including the five step model, but cuts out the specificity in the standard in areas where the issues covered are less relevant to SME accounts, or introduce a level of complexity that would not be proportionate for SME accounting.
41. We believe that this could be achieved, for example, as follows:
  - a) In 'Identifying the contract', remove the guidance on contract modifications.
  - b) In 'Identifying the performance obligations', reduce the guidance on performance obligations being distinct.
  - c) In 'Satisfaction of performance obligations', remove the guidance on 'Methods for measuring progress'.
  - d) In 'Determining the transaction price', simplify and shorten the guidance on variable consideration and remove the guidance on the existence of a significant financing component.
  - e) In 'Allocating the transaction price to performance obligations', remove the guidance on allocation of a discount.

The guidance on costs at paragraphs 91 to 98 could be removed and the section on disclosures could be simplified and shortened, so long as the IFRS for SMEs retained a requirement to disclose the revenue recognition accounting policy in detail. The application material could just be translated into examples, where relevant, and included in the appendix to Section 23, as in the extant IFRS for SMEs.