ICAEW
REPRESENTATION 18/23

EXPOSURE DRAFT - THIRD EDITION OF THE IFRS FOR SMES ACCOUNTING STANDARD

Issued 7 March 2023

ICAEW welcomes the opportunity to comment on the exposure draft of the Third Edition of the IFRS for SMEs Accounting Standard published by IASB in September 2022, a copy of which is available from this link.

For questions on this response please contact our Financial Reporting team at frf@icaew.com quoting REP 18/23.

We welcome the opportunity to comment on the proposed third edition of the IFRS for SMEs. The Board are to be commended for what has been achieved, with some excellent work being done on incorporating many new and revised standards. We do, however, have some specific comments, particularly on items – such as leases, revenue recognition and expected credit losses – that are likely to have a direct impact on UK GAAP.

This response of 07 March 2023 has been prepared by the ICAEW Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of sustainable economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 165,000 chartered accountant members in over 147 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

© ICAEW 2023
All rights reserved.
This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:
• it is appropriately attributed, replicated accurately and is not used in a misleading context;
• the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.
Where third-party copyright material has been identified application for permission must be made to the copyright holder.

ICAEW
Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
icaew.com

The Institute of Chartered Accountants in England and Wales (ICAEW) incorporated by Royal Charter (RC000246)
Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

KEY POINTS

OUR APPROACH TO RESPONDING TO THE EXPOSURE DRAFT

1. While UK companies are not able to adopt the IFRS for SMEs, it is a standard that nonetheless has some influence on our financial reporting regime, as much of UK GAAP is based upon it.
2. This comment letter concentrates primarily on issues that could be potentially significant from a UK perspective ie, those items that are likely to have a direct impact on UK GAAP. With this in mind, the primary focus of this response is on addressing the questions relating to leases, revenue recognition and expected credit losses.
3. We have also responded to other questions where appropriate but have only provided our high-level views on them.

WE BELIEVE THAT THE IFRS FOR SMEs SHOULD BE ALIGNED WITH IFRS 16

4. In our view, aligning the IFRS for SMEs with IFRS 16 Leases would not only mean that it is consistent with full IFRS but would also provide better information to users. We therefore encourage the Board to do so – making simplifications where appropriate – as part of this current update.
5. Deciding on whether to incorporate the principles of any standard into the IFRS for SMEs is always going to involve balancing costs and benefits. We recognise that the costs of incorporating IFRS 16's requirements in full could be onerous for some SMEs and the costs of doing so might outweigh the benefits. However, we believe that the benefits will outweigh the costs if suitable simplifications are made to IFRS 16.
6. We recognise, however, that many SMEs and their advisors are likely to have doubts about the benefits of adopting IFRS 16's leasing model. With this in mind, we will be undertaking extensive outreach with our membership to see what they think about the UK proposals to potentially exempt micro-entities and adopt a simplified version of the IFRS 16 model for all other companies entitled to use FRS 102.
7. See our response to question 12 below for more details.

WE SUPPORT THE INCLUSION OF IFRS 15's FIVE-STEP REVENUE RECOGNITION MODEL BUT BELIEVE MORE WORK IS NEEDED IN SOME AREAS

8. We agree with the proposals to align the IFRS for SMEs with IFRS 15 *Revenue from Contracts with Customers* and its five-step revenue recognition model. The Board are to be congratulated for ensuring that the proposals retain the principles of IFRS 15 while at the same time reducing the specificity in areas where the issues covered are less relevant to SME accounts and avoiding a level of complexity that would not be proportionate for SME accounting. We feel that the Board has got the balance about right between keeping things simple and providing sufficient guidance to enable preparers to apply this section consistently.
9. While we are very supportive of the approach taken and agree with many of the simplifications proposed, we do have a number of detailed comments.
10. See our response to question 8 and the appendix that accompanies this letter for more details.

WE DO NOT SUPPORT THE TWO-TIER APPROACH TO IMPAIRMENT OF FINANCIAL ASSETS AND BELIEVE THAT THE INCURRED LOSS MODEL SHOULD BE APPLIED TO ALL FINANCIAL ASSETS

11. We do not agree with the two-tier approach to impairment of financial assets proposed in the exposure draft as we believe that having two separate models – one of which would rarely be used by SMEs – would create unnecessary complexity and potential for confusion. We would therefore prefer that the existing incurred loss model continues to apply to all financial assets, including intercompany and similar receivables.
12. See our response to question 4 below for more details.

KEEPING IT SIMPLE

13. A number of substantial changes have been made to IFRS Accounting Standards in recent years, many of which are not reflected in the current version of the IFRS for SMEs, meaning that updating the standard was always going to be formidable task. The Board are to be commended for what has been achieved, with some excellent work being done on incorporating many new and revised standards.
14. We appreciate that there is an inherent tension between keeping the standard simple and making sure that sufficient guidance is included to ensure that it is understandable without creating a need to refer to full IFRS. We do, however, feel that – in some instances – too much text has been included from full IFRS and that more could be done to simplify things.
15. There is a marked contrast between some of the sections that were drafted when the standard was first developed and the proposed amendments, with the latter tending to be somewhat more verbose. This is particularly the case with regard to the proposed amendments to Section 2 *Concepts and Pervasive Principles*, Section 9 *Consolidated and Separate Financial Statements and Section 12 Fair Value Measurement*.
16. Looking back at when the IFRS for SMEs was first published in 2009, we note that it came in at 230 pages long. This contrasted with the 2009 bound volume of full IFRS that contained 2,855 pages. In other words, over 90% of the text had been eliminated as the requirements were trimmed and cut back to the bare essentials in order to make them suitable to an SME audience. The current proposals do not always appear to have been so effective in eliminating unnecessary detail.
17. Including too much detailed text risks undermining some of the standard's unique features ie, that it is easy to read and simple to apply. We believe that it is important to ensure that the IFRS for SMEs reflects the same principles and definitions as full IFRS, with more straight-forward application requirements as appropriate. But at the same time, it is also imperative that things are kept as simple as possible. With this in mind, we suggest that the Board revisits the principles set out in paragraph BC16 of the Basis for Conclusions and thinks carefully about what further editing could be done to ensure that the new text contains a level of detail is consistent with what has gone before. Failing to do so risks not only creating a standard that is not only unbalanced but also more difficult for preparers to apply.
18. Nevertheless, in some cases, particularly in relation to revenue from contracts with customers, more guidance might be helpful as there are some new technical concepts that are not always intuitive without examples. However, to avoid cluttering the standard with too much information, we would encourage the IFRS Foundation to update its existing educational modules to include added notes, examples and case studies to explain and illustrate these requirements.

© ICAEW 2023

ANSWERS TO SPECIFIC QUESTIONS

Question 1 – Definition of public accountability

Respondents to the Exposure Draft Subsidiaries without Public Accountability: Disclosures, published in July 2021, expressed some concerns about applying the definition of public accountability. The description of 'public accountability' in the Exposure Draft Subsidiaries without Public Accountability: Disclosures comprises the definition and supporting guidance in paragraphs 1.3–1.4 of the IFRS for SMEs Accounting Standard (Standard).

In response to this feedback, the IASB is proposing to amend paragraph 1.3(b) to list banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks as examples of entities that often meet the second criterion of public accountability in paragraph 1.3(b). To assist an understanding of the basis for the definition of public accountability, the IASB is also proposing to clarify that an entity with these characteristics would usually have public accountability:

(a) there is both a high degree of outside interest in the entity and a broad group of users of the entity's financial statements (existing and potential investors, lenders and other creditors) who have a direct financial interest in or substantial claim against the entity.

(b) the users in (a) depend primarily on external financial reporting as their means of obtaining financial information about the entity. These users need financial information about the entity but lack the power to demand the information for themselves.

Paragraphs BC11–BC19 of the Basis for Conclusions on this Exposure Draft explain the IASB's rationale for clarifying the definition of public accountability in Section 1. The IASB expects that the amendments to paragraphs 1.3 and 1.3A of Section 1 will add clarity, without changing the intended scope of the Standard.

1(i) Do you agree that the amendments will add clarity without changing the intended scope of the Standard? If you do not agree, which types of entities do you believe would be newly scoped in or scoped out?

1(ii) Do you agree with the proposal to clarify the definition of public accountability? If you do not agree with the proposal, please explain what you suggest instead and why.

19. A well-established principle is that standard-setters should bear in mind the incentives of preparers. In the context of Section 1, preparers may seek to fall outside of the definition of 'public accountability'. So, any weakening of the phrasing around 'public accountability' is not in our opinion desirable. We can see the point of the proposed replacement of 'most' by 'often' in paragraph 1.3, because this is an empirical matter on which the standard presents no evidence. However, the proposed change would contribute to a weakening of the phrasing.
20. In our view, the list of sectors (including banks and insurance companies) provided in paragraph 1.3 (b) is sensible. However, we think that the standard should clearly state that all such entities other than captive insurance companies have public accountability.
21. At the very least, such entities should be required to present persuasive evidence before they can escape from full IFRS reporting. One alternative approach would be to establish a rebuttable presumption that entities in certain sectors do have public accountability. An entity seeking to avoid full IFRS would then have to convince auditors, regulators and users that this would be justified. The list of sectors and this presumption could be put at the end of the proposed new paragraph 1.3A.
22. This proposed new paragraph 1.3A is already helpful as currently drafted, though we think that an 'and' should be added between parts (a) and (b).
23. The Basis for Conclusions makes it clear that the intention of paragraph 1.3A is to clarify why the entities in paragraph 1.3(b) would often be considered to have public accountability. This is not, however, clear from reading the draft standard itself and some could read this paragraph in isolation and think that the intention is to widen the scope of which entities are considered to have public accountability. Some minor redrafting is necessary to avoid the potential for confusion.

© ICAEW 2023

Question 2 – Revised Section 2 Concepts and Pervasive Principles

The IASB in its Request for Information asked for views on aligning Section 2 Concepts and Pervasive Principles with the Conceptual Framework for Financial Reporting, issued in 2018. In the Request for Information, the IASB noted that the 1989 Framework for the Preparation and Presentation of Financial Statements (1989 Framework) had provided the foundations of the Standard.

Based on feedback on the Request for Information, the IASB is proposing to revise Section 2 to align it with the 2018 Conceptual Framework for Financial Reporting.

The IASB is proposing that Section 18 Intangible Assets other than Goodwill and Section 21 Provisions and Contingencies continue to use the definitions of an asset and of a liability from the previous version of Section 2, which was based on the 1989 Framework, to avoid unintended consequences arising from revising the definitions of an asset and of a liability.

Paragraphs BC38–BC51 of the Basis for Conclusions on this Exposure Draft explain the IASB's rationale for the revisions proposed for Section 2.

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

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)?

24. We agree with aligning the IFRS for SMEs with the 2018 *Conceptual Framework* and making amendments to other sections of the standard where appropriate. We do, however, note that the new section is approximately twice as long as the previous version. Moreover, the language that is used is often harder to understand when compared to what went before. We therefore encourage the Board to consider whether this section could be made clearer and more succinct.
25. The *Conceptual Framework* is designed, among other things, to assist the IASB to develop IFRS Accounting Standards that are based on consistent concepts. As such, it is perhaps inevitable that some of the language is going to be highly technical in nature. But that is not the purpose of Section 2 of the IFRS for SMEs. It should therefore be possible to simplify the language and make it more useful for preparers who are referred to it by other sections of the standard, such as when developing an accounting policy in the absence of specific guidance.
26. We are not overly concerned about the inconsistencies between the definitions of an asset and a liability that are included in Section 2 and other sections of the standard as these inconsistencies also exist in full IFRS. However, for the avoidance of doubt, the Board may wish to add something equivalent to IFRS 3.23A to Section 19 *Business Combinations* and Goodwill clarifying that an acquirer should not recognise a contingent asset at the acquisition date, as this is highlighted as a possible conflict with the *Conceptual Framework* in full IFRS.
27. Changes to this section may mean that some entities have to revisit and potentially revise previous accounting treatments as they may no longer be consistent with the newly framed concepts and pervasive principles, especially given the increased focus on control rather than risks and rewards. While we do not believe that this issue is likely to be widespread, the Board should ensure that this possibility is considered and that it is made clear whether entities will be expected to revise their accounting policies in such circumstances.

Question 3 – Proposed amendments to the definition of control in Section 9 Consolidated and Separate Financial Statements

The IASB in its Request for Information asked for views on aligning the definition of control in Section 9 Consolidated and Separate Financial Statements with the definition in IFRS 10 Consolidated Financial Statements and using that definition as the single basis for consolidation (control model) to facilitate greater consistency between financial statements prepared applying the Standard.

Respondents to the Request for Information were in favour of the alignment, and the IASB is proposing amendments to align Section 9 with IFRS 10, introducing control as the single basis for consolidation that applies to all entities.

The IASB is proposing to retain the rebuttable presumption that control exists when an investor owns more than a majority of the voting rights of an investee. The rebuttable presumption is a simplification of the control model.

Paragraphs BC52–BC62 of the Basis for Conclusions on this Exposure Draft explain the IASB's rationale for aligning the definition of 'control' in Section 9 with IFRS 10 and introducing a control model as the single basis for consolidation.

Do you agree with the IASB's proposal to retain the rebuttable presumption as a simplification of the definition of control? If not, please explain why you do not agree with this simplification.

28. We are supportive of aligning the definition of control with that used in IFRS 10 and agree with the proposal to retain the rebuttable presumption.

Question 4 – Proposed amendments to impairment of financial assets in Section 11 Basic Financial Instruments (renamed Financial Instruments)

The IASB in its Request for Information asked for views on replacing the incurred loss model for the impairment of financial assets in Section 11 Basic Financial Instruments with an expected credit loss model aligned with the simplified approach in IFRS 9 Financial Instruments. Feedback suggested that the simplified approach in IFRS 9 would be complex for SMEs to apply and would not result in substantial changes in the amount of impairment for the types of financial assets held by typical SMEs, namely short-term trade receivables.

The IASB anticipates that an expected credit loss model would provide relevant information for users of financial statements when SMEs hold longer-term financial assets. Consequently, the IASB is proposing to:

(a) retain the incurred loss model for trade receivables and contract assets in the scope of the revised Section 23 Revenue from Contracts with Customers;

(b) require an expected credit loss model for all other financial assets measured at amortised cost, aligned with the simplified approach in IFRS 9; and

(c) retain the requirements in Section 11 for impairment of equity instruments measured at cost.

Paragraphs BC72–BC80 of the Basis for Conclusions on this Exposure Draft explain the IASB's rationale for introducing an expected credit loss model for only some financial assets.

4(i) Do you agree with the proposal to introduce an expected credit loss model for only some financial assets? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

4(ii) Do you agree that the proposal strikes the right balance in deciding which financial assets should be in the scope of the expected credit loss model, considering the costs for SMEs and benefits for users of SMEs' financial statements?

We do not support the proposed two-tier approach

29. We do not agree with the two-tier approach to impairment of financial assets proposed in the exposure draft as we believe that having two separate models – one of which would rarely be used by SMEs – would create unnecessary complexity and potential for confusion.

Trade receivables, contract assets and financial assets measured at cost

30. IFRS 9's expected loss model was developed in response to the 2007-08 global financial crisis, when concerns were raised about banks and other financial institutions providing 'too little, too late' when it came to credit losses on long-term financial assets such as their loan and mortgage books. A more cautious approach was subsequently introduced, with businesses required to recognise 'expected' rather than 'incurred' credit losses.

31. This expected loss model makes a lot of sense for banks and other financial institutions but they are generally outside of the scope of the IFRS for SMEs. We do not believe, therefore, that this approach is suitable or proportionate for SMEs, many of whom hold only short-term financial assets such as trade receivables. Moving to an expected loss model may be costly for some SMEs. Moreover, it is unlikely to result in a significant change in the impairments recognised as in most cases the less timely preparation of SME financial statements mean that losses incurred at the reporting date are already captured and adjusted for. We therefore agree that it is more appropriate to retain the existing incurred loss model for trade receivables, contract assets and financial assets measured at cost.

Other financial assets measured at amortised cost

32. The Board is proposing that a simplified version of IFRS 9's expected loss model is applied to other financial assets measured at amortised cost. The work that has been done in coming up with this simplified approach should be applauded. However, we believe that including separate requirements for such assets would create unnecessary complexity and potential for confusion.
33. We would therefore prefer that the existing incurred loss model continues to apply to **all** financial assets.

Intercompany loans

34. Under IFRS 9, companies are required to apply the expected loss model to intercompany and similar receivables such as directors' loans. This created a number of complications and challenges when IFRS 9 was first introduced. To avoid these issues arising when the IFRS for SMEs is updated, we suggest that the existing incurred loss model continues to apply to such assets.
35. Under the approach we are suggesting, all financial assets – including intercompany and similar receivables – would be subject to impairment testing based on the existing incurred loss model with losses recognised only when there is objective evidence of impairment. If the Board decides to stick with its proposed two-tier approach, we suggest that an exception to the general rule is made that requires the incurred loss model to be applied to intercompany and similar receivables as doing so would better reflect cost and benefit considerations.

Question 5 – Proposal for a new Section 12 Fair Value Measurement

The IASB in its Request for Information asked for views on aligning the Standard with IFRS 13 Fair Value Measurement and introducing illustrative examples into the Standard. This alignment would not amend the requirements for when to use fair value measurement.

Respondents to the Request for Information favoured aligning the Standard with the definition of fair value in IFRS 13 to provide clarity and enhance comparability between financial statements prepared applying the Standard. The IASB is proposing that the requirements on measuring fair value and related disclosure requirements be consolidated in a new Section 12 Fair Value Measurement.

Paragraphs BC108–BC118 of the Basis for Conclusions on this Exposure Draft explain the IASB's rationale for this proposal.

Do you have comments or suggestions on the new Section 12? Please explain the reasons for your suggestions.

Support for aligning the IFRS for SMEs with IFRS 13

36. We are supportive of the proposals to align the IFRS for SMEs with IFRS 13. We agree with bringing in the IFRS 13 definition of fair value together with the related guidance and examples on measuring fair value and applying the fair value hierarchy. Doing so should lead to greater clarity and consistency when SMEs are permitted or required to use a fair value measurement.
37. We are also supportive of including these requirements and the related disclosure requirements in a separate section of the IFRS for SMEs.

Further simplification is needed

38. We note, however, that more guidance has been included than is typically the case when incorporating the requirements of full IFRS into the IFRS for SMEs. Further simplification may be appropriate to ensure that these requirements are not unnecessarily long or complex.
39. For example, paragraphs 12.11-12.13 on highest and best use could easily be excluded or further abridged. In this case, these additional paragraphs are simply adding guidance to basic principles that have already been set out.
40. We believe that including this and other guidance elsewhere in this section risks making it disproportionately long when compared to other sections of the standard. We suggest that the Board revisits the principles set out in paragraph BC16 of the Basis for Conclusions and thinks carefully about whether all of the detailed guidance provided is really necessary. It may also be useful for the Board to consider the abridged version of IFRS 13 that the UK's Financial Reporting Council has developed as part of its periodic review of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. Their proposals are more succinct than Section 12 of the IFRS for SMEs as currently drafted but still manage, in our view, to retain the IFRS 13's core principles.

Question 6 – Proposed amendments to Section 15 Investments in Joint Ventures (renamed Joint Arrangements)

The IASB in its Request for Information asked for views on aligning the definition of joint control with IFRS 11 Joint Arrangements, while retaining the three classifications of joint arrangements in Section 15 Investments in Joint Ventures (jointly controlled operations, jointly controlled assets and jointly controlled entities).

Respondents to the Request for Information favoured aligning the definition of joint control. However, respondents expressed mixed views on whether to align the classification and measurement requirements with IFRS 11 or to retain the Section 15 classification and measurement requirements.

The IASB is proposing to align the definition of joint control and retain the Section 15 classification and measurement requirements as set out in the Request for Information.

Paragraphs BC119–BC127 of the Basis for Conclusions on this Exposure Draft explain the IASB's rationale for these proposals.

6(i) Do you agree with the IASB's proposal to align the definition of joint control and retain the classification of a joint arrangement as jointly controlled assets, a jointly controlled operation, or a jointly controlled entity, and the measurement requirements for these classifications? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

The IASB is also proposing amendments to align Section 15 with the requirements of paragraph 23 of IFRS 11, so that a party to a jointly controlled operation or a jointly controlled asset that does not have joint control of those arrangements would account for its interest according to the classification of that jointly controlled operation or the jointly controlled asset.

Paragraphs BC128–BC129 of the Basis for Conclusions on this Exposure Draft explain the IASB's rationale for this proposal.

6(ii) Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

We do not support the proposed hybrid approach

41. We are not supportive of the proposals to align the definition of joint control with that set out in IFRS 11 while retaining the existing classification and measurement requirements. While such a hybrid approach could work in principle, we believe that doing so would not only embed an inconsistency with full IFRS but that it is also likely to confuse users of SMEs' financial statements, especially those familiar with full IFRS. The arguments for taking this approach, as

set out in the Basis for Conclusions, rely on the simplicity principle and cost-benefit considerations but do not explain why they are judged to be more important than the principles of relevance and faithful representation.

42. Matters are only further confused by the proposal to bring in the requirements of paragraph 23 of IFRS 11, so that a party to a jointly controlled operation or a jointly controlled asset that does not have joint control of those arrangements would account for its interest according to the classification of that jointly controlled operation or the jointly controlled asset. While we appreciate what the Board is trying to achieve, we find the drafting very difficult to follow – not least because of the unexplained introduction of the concept of a ‘vehicle’ in paragraph 15.18A (which addresses the accounting by a party that participates in but does not have joint control of a jointly controlled entity) which seems to conflict with the use of ‘party’ throughout the whole of paragraphs 15.8-15.17.
43. In our view, it would be better to align Section 15 of the IFRS for SMEs more closely with the principal requirements of IFRS 11 with simplifications made where appropriate to make them easier to apply in practice.
44. One simplification to IFRS 11 that we would support relates to the application of the concept of joint control. We believe that, when a joint arrangement takes the form of a legal entity, the reporting entity should be able to assume that it is a joint venture. This would mean that it would be able to apply the equity method without needing to first assess the facts and circumstances. This assessment involves a degree of sophistication that we believe could be omitted for SMEs.

Question 7 – Proposed amendments to Section 19 Business Combinations and Goodwill

Based on the feedback to the Request for Information, the IASB is proposing to align Section 19 Business Combinations and Goodwill with the acquisition method of accounting in IFRS 3 Business Combinations* by:

(a) adding requirements and guidance for a new entity formed in a business combination;

(b) updating the references when recognising the identifiable assets acquired and liabilities assumed in a business combination to refer to the definitions of an asset and a liability in the revised Section 2 Concepts and Pervasive Principles;

(c) clarifying that an acquirer cannot recognise a contingency that is not a liability;

(d) requiring recognition of acquisition-related costs as an expense;

(e) requiring measurement of contingent consideration at fair value if the fair value can be measured reliably without undue cost or effort; and

(f) adding requirements for an acquisition achieved in stages (step acquisitions).

For other aspects of the acquisition method of accounting, the IASB is proposing to retain the requirements in Section 19. The IASB is of the view that:

(a) the guidance in IFRS 3 on reacquired rights is unlikely to be relevant to entities applying the Standard;

(b) restricting the measurement of non-controlling interest in the acquiree to the non-controlling interest’s proportionate share of the recognised amounts of the acquiree’s identifiable net assets (and not introducing the fair value option) is an appropriate simplification; and

(c) retaining recognition criteria for intangible assets acquired in a business combination balances the costs and benefits of separate recognition of these items because goodwill recognised in a business combination is amortised.

Paragraphs BC130–BC183 of the Basis for Conclusions on this Exposure Draft further explain the IASB’s rationale for these proposals.

Paragraph BC177 of the Basis for Conclusions on this Exposure Draft explains that there were mixed views on whether step acquisitions are relevant to SMEs. The IASB is asking for views on adding requirements for step acquisitions and on the proposed requirements

themselves. Asking for views on whether to add requirements allows stakeholders to evaluate the proposals when responding to this Invitation to Comment.

7(i) Do you agree with the proposal to introduce requirements for the accounting for step acquisitions? If your answer is yes, do you agree with the proposed requirements in the Exposure Draft? If you disagree with the proposal, please explain why and give your alternative suggestion.

7(ii) Do you agree that the IASB's proposals appropriately simplify the measurement of non-controlling interests by excluding the option to measure them at fair value? If your answer is no, please explain your reasons.

7(iii) Do you have any further comments or suggestions on the proposed amendments to Section 19? Please explain the reasons for your suggestions.

45. We are generally supportive of the proposals, which manage to find a good balance between converging with full IFRS and remaining understandable and practical.
46. We agree with the proposals to introduce requirements relating to step acquisitions.
47. We also agree that it is appropriate to exclude the option of measuring non-controlling interests at fair value.

Question 8 – Revised Section 23 Revenue (renamed Revenue from Contracts with Customers)

The IASB in its Request for Information asked for views on possible approaches to aligning Section 23 Revenue with IFRS 15 Revenue from Contracts with Customers. Respondents favoured this alignment without identifying a preferred approach.

Consequently, the IASB is proposing to revise Section 23 to align it with the principles and language used in IFRS 15. The revised requirements are based on the five-step model in IFRS 15, with simplifications that retain the basic principles in IFRS 15 for recognising revenue.

Paragraphs BC184–BC193 of the Basis for Conclusions on this Exposure Draft further explain the IASB's rationale for this proposal and the proposed simplifications of the IFRS 15 requirements.

8(i) Do you agree that the revised Section 23 would be appropriate for SMEs and users of their financial statements? If not, what modifications—for example, further simplifications or additional guidance—do you suggest and why?

Determining whether a good or service promised to a customer is distinct can involve judgement. To assist entities in making this assessment, the IASB is proposing to simplify the requirements in paragraphs 27–29 of IFRS 15 by:

(a) specifying that a good or service that an SME regularly sells separately is capable of being distinct (see paragraph 23.21 of the Exposure Draft);

(b) expressing the criterion in paragraph 27(b) of IFRS 15 in simpler language and reflecting the objective of the criterion by focusing on whether a good or service is an input used to produce a combined item or items transferred to the customer (see paragraphs 23.20(b) and 23.23 of the Exposure Draft); and

(c) including examples that illustrate the factors supporting that criterion (see paragraph 23.23(a)–(c) of the Exposure Draft).

8(ii) Do you believe the guidance is appropriate and adequate for entities to make the assessment of whether a good or service is distinct? If not, is there any guidance that could be removed or additional guidance that is needed?

Support for aligning the IFRS for SMEs with IFRS 15

48. We agree with the proposals to align the IFRS for SMEs with IFRS 15 and its five-step revenue recognition model. The Board are to be congratulated for ensuring that the proposals retain the principles of IFRS 15 while at the same time reducing the specificity in areas where the issues covered are less relevant to SME accounts and avoiding a level of complexity that would not be proportionate for SME accounting. We feel that the Board has got the balance

about right between keeping things simple and providing sufficient guidance to enable preparers to apply this section consistently.

49. Reflecting the principles and language used in IFRS 15 in the IFRS for SMEs ensures consistency of approach and avoids the operation of two different models of revenue recognition.
50. We are very supportive of the approach taken and agree with many of the simplifications proposed, including the guidance to help entities to assess whether or not a good or service is distinct. We do, however, have a number of detailed comments and suggested improvements to the proposals which are discussed below.

Principal vs agent

51. IFRS 15's guidance on whether an entity is acting as a principal or an agent can be challenging to apply in practice. Many companies and their advisors find it difficult to understand these requirements and, in our experience, they lead to more application questions than any other part of the standard. We therefore agree that something needs to be done when incorporating these requirements into the IFRS for SMEs in order to make it simpler for SMEs to determine whether they are acting as a principal or an agent.
52. While we are supportive of what the Board has sought to achieve in the exposure draft, we do not believe that the proposed drafting of paragraph 23.38 is quite right. We think that it is important that the IFRS for SMEs guidance is based on – and is seen to be based on – the same core principles as IFRS 15. However, because the drafting is significantly different, there may be concerns over whether the approach taken in the exposure draft is in fact based on the same principles. This is likely to cause confusion – particularly among those familiar with IFRS 15 – and may result in different outcomes occurring.
53. IFRS 15.B35 provides an overarching principle that an entity is a principal if it 'controls the specified good or service before that good or service is transferred to a customer'. This is then supported by IFRS 15.B37 which provides a list of three example indicators that an entity controls the specified good or service before it is transferred to the customer and is therefore the principal.
54. The proposals in paragraph 23.38 take a somewhat different approach, listing three criteria and indicating that an entity would be a principal if any one of them is met. The third of these criteria is the overarching principle from IFRS 15.B35, while the others are two of the three indicators provided in IFRS 15.B37. Moreover, the third indicator from IFRS 15.B37 – which talks about having discretion in establishing the price for the specified good or service and which in some cases can be pivotal – has not been included.
55. This is somewhat muddled and, as noted above, there may be concerns about whether what is being proposed is actually consistent with IFRS 15's core principles. We believe that any changes to these core principles should be made only as part of the post-implementation review of that standard rather than as part of this update to the IFRS for SMEs.
56. We suggest that paragraph 23.38 is rewritten to include a simplified version of the approach currently included in IFRS 15. We believe that having control of a specified good or service before that good or service is transferred to a customer is critical in determining whether an entity is a principal and that this should be clearly stated upfront. We therefore suggest that the Board redrafts the requirements in the IFRS for SMEs so that they begin by outlining the overarching principle from IFRS 15.B35 before going on to separately list all of the indicators from IFRS 15.B37. This approach would result in a solution that is not only consistent with that in IFRS 15 but that is also relatively short and succinct.
57. In addition, we think that the guidance would be much easier to digest if it distinguished between scenarios in which:
    - an entity obtains control of a specified good or service and subsequently transfers control of that good or service to the customer; and
    - an entity obtains control of a promise made by another party to provide a specified good or service and subsequently transfers control of that promise to the customer.

58. Those latter scenarios cause confusion, because the entity is a principal in respect of the sale of that promise, but not in respect of the goods and services embodied in that promise. In our experience, these latter scenarios tend to be the hardest to assess in practice. We would be happy to discuss this further with you.

Promises satisfied over time

59. Paragraph 23.78 is based on IFRS 15.35 but a number of changes to the existing wording have been made. Although we understand the motivation behind these changes, we think it is essential that the principles underpinning this part of the IFRS for SMEs can be seen to be completely consistent with IFRS 15. In order to avoid unintended consequences, we strongly suggest that the wording of IFRS 15.35 is repeated verbatim in section 23.
60. To illustrate our concerns with the redrafting, we would highlight the following examples:
    - The redrafting in paragraph 23.78(d) seems inadvertently to have created a difference from IFRS 15.35(c). Paragraph 23.78(d) requires an asset to exist, whereas IFRS 15.35(c) requires that there is no asset with an alternative use to the supplier – ie, if no asset exists, the test could be met in IFRS 15.35(c) but not in paragraph 23.78(d).
    - The redrafting in paragraph 23.78(c) also seems inadvertently to have created a difference from IFRS 15.35(b). Paragraph 23.78(c) requires the entity's performance to create or enhance an asset 'that the customer obtains control of' as the asset is created or enhanced whereas IFRS 15.35(b) refers to creating or enhancing an asset 'that the customer controls' as the asset is created or enhanced. There is a risk that different outcomes will arise as there is a difference between 'obtaining control' of an asset and 'controlling' it. For example, a train operator engaging a third party to come to its rail yard and renovate some of its carriages will have control of those carriages throughout the life of the contract. Under IFRS 15, the contract would qualify for over time revenue recognition as the train operator **controls** the asset throughout the life of the contract. But the treatment under the IFRS for SMEs as drafted is less clear as the train operator would have **obtained control** of the carriages when it first purchased them. Some may conclude that this means that the revenue has to be recognised at a point in time, which to us would be the wrong answer.
    - An additional criterion has been added at paragraph 23.78(b). This is taken from Appendix B of IFRS 15 and is in fact an example of a situation where a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. As such, we believe that it should be included as part of paragraph 23.78(a) rather than being listed as a separate criterion. In our view, including this point as a separate criterion results in it having unnecessary prominence and may have unintended consequences.
61. Although we believe that it is important for the IFRS for SMEs not to amend the existing wording from IFRS 15.35, we believe it might be helpful to supplement the wording of IFRS 15.35(c) to ensure its meaning is clear. Accordingly, we would favour adding the following words to those taken from IFRS 15.35(c): 'In other words, the first condition is that either no asset is created or any created asset has no alternative use to the entity'.

Other areas where improvements could be made

62. These fall into the following categories:
    - Areas where we believe more guidance or clarification is needed;
    - Areas where we believe additional simplifications should be considered; and
    - Areas where the IFRS 15 wording has been deliberately changed but where we believe there will be unintended negative consequences
63. The appendix to this letter provides a summary of our main concerns and includes suggested solutions as appropriate.

Transition

64. Concerns have been expressed 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 are pleased that the IASB has allowed SMEs the option of applying the new Section 23 prospectively to contracts that begin after the date of initial application, without the need to change their accounting policy for any contracts in progress at that date.

Question 9 – Proposed amendments to Section 28 Employee Benefits

The IASB in its Request for Information asked for views on applying paragraph 28.19 of the Standard, that is the measurement simplifications for defined benefit obligations.

The feedback identified challenges when applying paragraph 28.19, resulting in diversity of application. However, the feedback also provided evidence that only a few entities apply paragraph 28.19. Therefore, the IASB is proposing to delete paragraph 28.19. Paragraphs BC197–BC203 of the Basis for Conclusions on this Exposure Draft explain the IASB's rationale for this proposal.

9(i) Do you agree that only a few entities apply the measurement simplifications for defined benefits? Therefore, do you agree with the IASB's proposal to delete paragraph 28.19?

Alternatively, if you do not agree with deleting paragraph 28.19, should the IASB clarify the paragraph by:

(a) stating that an entity may apply any, or all, of the simplifications permitted by paragraph 28.19 when measuring a defined benefit obligation; and

(b) explaining that when an entity applies paragraph 28.19(b), examples of future service of current employees (assumes closure of the plan for existing and any new employees) that can be ignored include:

> ***(i) the probability of employees' not meeting the vesting conditions when the vesting conditions relate to future service (future turnover rate); and***
>
> ***(ii) the effects of a benefit formula that gives employees greater benefits for later years of service.***

9(ii) If you disagree with the proposal in 9(i), do you agree that this alternative approach clarifies paragraph 28.19?

65. We are supportive of the proposals to delete paragraph 28.19. This paragraph is already excluded from UK GAAP.

Question 10 – Transition

The IASB, in paragraphs A2–A39 of this Exposure Draft, sets out limited relief from retrospective application for those proposed amendments for which the IASB thought the costs of retrospective application would exceed the benefits. Do you agree with the proposed transition requirements for the amendments to the IFRS for SMEs Accounting Standard? Why or why not? If not, please explain what you suggest instead and why.

66. We have commented on transition requirements, where appropriate, in our responses to the other questions.

Question 11 – Other proposed amendments

Table A1, included in the Introduction, summarises the proposals for amending sections of the Standard not included in questions 2–10.

Do you have any comments on these other proposed amendments in the Exposure Draft?

67. Although we have not studied all of the other proposed amendments in detail, we are generally supportive of them as they aim to maintain consistency with full IFRS.

Question 12 – Section 20 Leases and IFRS 16 Leases

The IASB in its Request for Information asked for views on aligning Section 20 Leases with IFRS 16 Leases by simplifying some of the recognition and measurement requirements, the disclosure requirements and the language of IFRS 16.

Feedback on the Request for Information was mixed. Stakeholders suggested the IASB assess the costs and benefits of aligning the Standard with IFRS 16, even with the simplifications, and obtain more information about the experience of entities that apply IFRS 16.

The IASB decided not to propose amendments to Section 20 at this time and to consider amending the Standard to align it with IFRS 16 during a future review of the Standard. Therefore, the Exposure Draft does not propose amendments to Section 20. In making this decision the IASB placed greater emphasis on cost–benefit considerations and prioritised timing—that is, to obtain more information on entities' experience of applying IFRS 16.

The IASB is asking for further information on cost–benefit considerations, particularly on whether:

(a) aligning Section 20 with IFRS 16 at this time imposes a workload on SMEs disproportionate to the benefit to users of their financial statements— specifically, considering:

> ***(i) the implementation costs that preparers of financial statements could incur;***
>
> ***(ii) the costs that users of financial statements could incur when information is unavailable; and***
>
> ***(iii) the improvement to financial reporting that would be realised from recognising the lessee's right to use an underlying asset (and the lessee's obligation to make lease payments) in the statement of financial position.***

(b) introducing possible simplifications—for example, for determining the discount rate and the subsequent measurement of the lease liability (reassessment)— could help to simplify the requirements and reduce the cost of implementing an amended Section 20 (aligned with IFRS 16) without reducing the usefulness of the reported information.

Paragraphs BC230–BC246 of the Basis for Conclusions on this Exposure Draft further explain the IASB's rationale for not proposing amendments to Section 20 at this time and instead for considering amending the Standard to align it with IFRS 16 during a future review of the Standard.

Do you agree with the IASB's decision to consider amending the Standard to align it with IFRS 16 in a future review of the Standard? In responding to this question, please comment on the cost–benefit considerations in paragraphs (a) and (b).

Support for aligning the IFRS for SMEs with IFRS 16

68. In our view, aligning the IFRS for SMEs with IFRS 16 would not only mean that it is consistent with full IFRS but would also provide better information to users. We therefore encourage the Board to do so – making simplifications where appropriate – as part of this current update.
69. We are not convinced by the Board's arguments for deferring consideration of the alignment of the IFRS for SMEs with IFRS 16. In particular, we are surprised to hear that the Board wants to wait until users have 'more experience' of applying IFRS 16 before incorporating its requirements into the IFRS for SMEs. IFRS 16 has been effective since 1 January 2019. Moreover, much of the work on implementing it was undertaken well in advance of that date. For most IFRS adopters, applying the standard is now very much business as usual. It is therefore hard to imagine what additional insights and experiences will emerge at this stage.
70. We acknowledge that the Board received mixed feedback in response to its Request for Information, with most of those opposed to bringing IFRS 16's principles into the IFRS for SMEs saying that the Board should gain a better understanding of IFRS 16 implementation issues and costs before doing so. However, we note that these concerns were raised more than two years ago and more information on these issues is now available.

© ICAEW 2023

71. We are also disappointed to read that the Board has suggested waiting until the post-implementation review of IFRS 16 is complete before deciding on how and when to incorporate the standard's requirements into the IFRS for SMEs. We note that post-implementation reviews have yet to be completed for other recent standards such as IFRS 9 and IFRS 15 but that the Board is happy to proceed with aligning the IFRS for SMEs with these standards. The approach proposed is not consistent.
72. We also feel that the Board is placing too much emphasis on what it describes as the 'disproportionate' workload that applying the principles of IFRS 16 would impose on SMEs while downplaying the many benefits of doing so (which are listed in paragraph BC 242 of the Basis for Conclusions).
73. In our experience, many smaller businesses have successfully adopted IFRS 16 without incurring excessive costs. There will always be some set up costs as businesses seek to identify which leases and other contracts are within scope and set up appropriate systems. But these are one-off costs that will not be incurred on an ongoing basis. Moreover, they are likely to be small when compared to the costs incurred by larger entities that have already adopted the standard as SMEs typically have a relatively small number of fairly straightforward leases. The number and nature of leases typically held by SMEs also means that many of the potential complications that come with applying IFRS 16's lessee accounting model are likely to have limited impact on them in practice.
74. We do, however, acknowledge that some SMEs will have a significant number of complex leases but these are likely to be in the minority and their circumstances should not be used as reason for deferring the alignment of the IFRS for SMEs with IFRS 16. Instead, appropriate simplifications, scope limitations and transitional relief should be provided to ensure that the impact on such entities is not excessive.
75. Possible simplifications and scope limitations and our thoughts on transitional relief are discussed further in paragraphs 78-83 below. We would encourage the Board to undertake suitable outreach activities to determine whether there is an appetite among its constituents for these and other ways of reducing the impact of introducing the IFRS 16's lessee accounting model into the IFRS for SMEs.
76. In our view, it is not sensible to have a single lease accounting model for lessees under full IFRS but two models (operating and finance) under IFRS for SMEs. This is the opposite of simplification.
77. Further, it is not useful to have to train accountants and users that some leases are treated radically differently under IFRS for SMEs compared to the treatment under full IFRS.

Possible simplifications

78. Deciding on whether to incorporate the principles of any standard into the IFRS for SMEs is always going to involve balancing costs and benefits. We recognise that the costs of incorporating IFRS 16's requirements in full could be onerous for some SMEs and the costs of doing so might outweigh the benefits. However, we believe that the benefits will outweigh the costs if suitable simplifications are made to IFRS 16.
79. One area that can be challenging is determining a suitable discount rate when it is not possible to determine the interest rate implicit in the lease. We believe that it may be appropriate to simplify these requirements when incorporating them into the IFRS for SMEs. One possible solution would be for the IFRS for SMEs to specify a particular interest rate or type of rate that must be used if it is not possible to determine the interest rate implicit in the lease. This is an approach adopted in the public sector in the UK, where all entities are required to use the HM Treasury discount rate as their incremental borrowing rate, unless they can demonstrate that another discount rate would be more appropriate. More recently, included in the FRC's proposed amendments to lease accounting under UK GAAP, is an option to use the lessee's obtainable borrowing rate for the purpose of discounting the lease liability. While we acknowledge that it will be challenging to come up with something equivalent that works in an international context, we nonetheless encourage the Board to look into this possibility.

80. Other areas where simplifications could be considered include determining the lease term, the impact of changes in key judgements during the lease term on the measurement of the lease liability and accounting for lease modifications. In particular, it may be sensible to allow an unchanged discount rate to be used whenever a change in key judgements means that the lease liability needs to be remeasured, rather than requiring a revised discount rate to be used in some instances as is the case under IFRS 16.

Possible scope limitations

81. Another way that the Board could reduce the burden for entities applying the IFRS for SMEs would be to, in some way, limit the scope of the standard and, hence, the number of situations in which IFRS 16's lessee accounting model applies. This could be done in a number of ways, including:
    - **Introducing size thresholds:** The Board may wish to consider exempting entities below a certain size threshold from applying IFRS 16's lessee accounting model. The UK's Financial Reporting Council has proposed this approach by suggesting that micro-entities should be exempt from these requirements, though we appreciate applying such an approach may be challenging internationally.
    - **Extending the low-value asset exemption:** IFRS 16 already includes an exemption for leases of low-value assets which allows entities to leave such leases off-balance sheet. The Basis for Conclusions accompanying IFRS 16 explains that when the Board were reaching decisions about this exemption, it had in mind leases of underlying assets with a value of US$5,000 or less. Many leases would fall out of scope if this threshold was raised to a higher amount of, say, US$50,000 and added to the IFRS for SMEs itself rather than being included in the Basis for Conclusions.
    - **Only requiring IFRS 16's lessee accounting model for certain leased assets:** Instead of applying a monetary threshold to determine which leases must appear on-balance sheet, the Board could instead set the scope so that only certain types of leases – such as property leases – are required to appear on-balance sheet. Again, this would mean that many leases would fall out of scope.

82. Adopting one or more of these approaches would mean that IFRS 16's core principles were at least being applied by either larger SMEs or to more valuable or more significant leases. This, in our opinion, would be better than not applying those principles at all.

Transition

83. It may also be appropriate to offer some transitional relief. For example, the Board may wish to consider making IFRS 16's lessee accounting model optional for leases with, say, less than three years to run at the date of transition. Doing so would not only ease transition but would also reduce the costs of adopting the new leasing model. Alternatively, a later implementation date could be attached to the leasing requirements.

Further consultation

84. Although we are supportive of aligning the IFRS for SMEs with IFRS 16, we firmly believe that the Board should not proceed without first consulting on how it proposes to do so. This could be done by issuing a separate exposure draft, possibly with a short consultation period so as not to delay things too much. It is important that any simplifications to IFRS 16 are subject to public consultation.

UK perspectives

85. The UK's Financial Reporting Council has issued proposals that would incorporate a simplified version of IFRS 16 into UK GAAP as part of its periodic review of FRS 102. Its proposals include optional simplifications in relation to interest rates, lease modifications, contracts with multiple components, sale and leaseback transactions, and variable lease payments. We encourage the Board to look at these proposals – particularly those affecting the discount rate

options – and consider whether they could form the basis of a simplified Section 20 of the IFRS for SMEs.

86. We recognise, however, that many SMEs and their advisors are likely to have doubts about the benefits of adopting IFRS 16's leasing model. With this in mind, we will be undertaking extensive outreach with our membership to see what they think about the UK proposals to potentially exempt micro-entities and adopt a simplified version of the IFRS 16 model for all other companies entitled to use FRS 102.

Question 13 – Recognition and measurement requirements for development costs

The Standard requires all development costs to be recognised as expenses, whereas IAS 38 Intangible Assets requires the recognition of intangible assets arising from development costs that meet specified criteria. This simplification in the Standard was made for cost–benefit reasons. However, feedback on this comprehensive review questioned this cost–benefit decision. Therefore, the IASB is seeking views on whether it should amend the Standard to align it with IAS 38, including views on the costs and benefits of doing so.

Paragraphs BC253–BC257 of the Basis for Conclusions on this Exposure Draft further explain the IASB's rationale.

What are your views on the costs and benefits, and the effects on users, of introducing an accounting policy option that permits an SME to recognise intangible assets arising from development costs that meet the criteria in paragraphs 57(a)–(f) of IAS 38? The entity would be required to demonstrate all of these criteria:

(a) the technical feasibility of completing the intangible asset so that it will be ready for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits;

(e) the availability of adequate technical, financial and other financial resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

87. We are supportive of the proposals to introduce an accounting policy option that permits an SME to recognise intangible assets arising from development costs provided certain criteria are met. Such an option is already available in the UK under FRS 102 and has not been problematic in practice.

Question 14 – Requirement to offset equity instruments

Paragraph 22.7(a) of the Standard states that if equity instruments are issued before an entity receives cash or other resources, the amount receivable is presented as an offset to equity in the statement of financial position, instead of being presented as an asset. Feedback from the first comprehensive review suggested that this requirement may conflict with local legislation. Stakeholders provided similar feedback during this second comprehensive review, suggesting that the IASB remove the requirement in paragraph 22.7(a) because it diverges from full IFRS Accounting Standards, which include no similar requirement for equity instruments.

What are your views on removing paragraph 22.7(a)?

88. We are supportive of the proposals to remove paragraph 22.7(a). This paragraph is already excluded from UK GAAP.

Question 15 – Updating the paragraph numbers of the IFRS for SMEs Accounting Standard

The proposed amendments to the requirements in the IFRS for SMEs Accounting Standard include the addition of new paragraphs and the deletion of existing paragraphs. A new

paragraph is numbered in continuation from a previous paragraph. A deleted paragraph retains the paragraph number.

Sometimes, the addition or deletion of paragraphs within a section may complicate the readability of the Standard (for example, Section 19 Business Combinations and Goodwill). As an alternative, a section may be revised, with paragraphs renumbered to show only requirements that would still be applicable, without a placeholder for deleted paragraphs (for example, Section 2 Concepts and Pervasive Principles).

What are your views on the approach taken to retain or amend paragraph numbers in each section of this Exposure Draft?

89. No comment.

APPENDIX – DETAILED COMMENTS ON SECTION 23 – REVENUE FROM CONTRACTS WITH CUSTOMERS

AREAS WHERE WE BELIEVE FURTHER GUIDANCE OR CLARIFICATION IS NEEDED

Promises rather than performance obligations

We note that the proposals refer to 'promises' instead of 'performance obligations' with the Basis for Conclusions explaining that this change has been made as the latter is more reflective of the language used by SMEs. We appreciate why this change has been proposed but are concerned that it may cause greater confusion as it introduces a subtle difference between how the term 'promise' is used in IFRS 15 and in the IFRS for SMEs.

When applying IFRS 15, entities initially identify the goods or services promised in the contract. If promised goods or services are not distinct, they are then bundled together with other promised goods or services until they become distinct together. Such a bundle is then treated as a single performance obligation.

We note that the proposed amendment to the IFRS for SMEs defines a 'promise' as being 'an obligation to transfer a good or service (or bundle of goods or services) that is distinct'. This contrasts with IFRS 15 where promised goods and services can and often will relate to items that are not distinct (and may need to be aggregated with other promised goods and services). This subtle difference may easily be missed, particularly by those familiar with applying IFRS 15, given that the definition of 'promise' is only given in the glossary of terms accompanying the standard.

On balance, in order to avoid confusion, we believe that it would be better for the IFRS for SMEs to be consistent with IFRS 15 and for it to refer to 'performance obligations' rather than 'promises'.

Contract modifications

Paragraph 23.13 omits the guidance that says that a contract modification may been approved but the price not agreed yet. This is very important in some industries, such as construction. We recommend that this guidance – and the idea that the associated pricing should be constrained as estimated variable consideration – is included in the IFRS for SMEs.

Repurchase agreements

IFRS 15's core principle relating to repurchase agreements has not been included in the proposals. We believe that this is an important principle and that it should be included in a simplified form. There is a link between IFRS 15's guidance on repurchase agreements and IFRS 16's guidance on sale and leaseback transactions – it would therefore be helpful to not only include this guidance in Section 23 but also to make reference to it in Section 20.

The time value of money

Paragraphs 23.58 and 23.59 imply that it is not mandatory to adjust for the time value of money when a customer pays significantly in advance. While we are supportive of this approach, we do not believe that the drafting is very clear about whether entities have a choice about making such adjustments. It would be helpful to explicitly state that such an adjustment is not required ie, that it a choice.

Discount rates

No guidance has been included on what discount rate to use when payment is received in arrears. We suggest the wording from IFRS 15.64 is included ie, the entity should use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.

Allocation of variable consideration

We found paragraphs 23.70 and 23.71 difficult to follow. We believe the guidance would be clearer if it was redrafted to focus more clearly on the concepts of IFRS 15.85(a).

Measuring progress towards complete satisfaction of a promise

Paragraph 23.92 lists common methods for measuring progress towards satisfaction of a promise and the circumstances in which they may be appropriate. In our experience, an input method based on costs is likely to be the most common approach applied. We therefore suggest that it is included as the first item in the list of possible methods. The conditional wording of this item is also rather opaque so we would suggest replacing it with something along the lines of '…based on costs incurred, provided that the costs used reflect performance on the contract and are considered a reasonable proxy for progress to date'. Finally, we suggest that labour hours expended is added to the list as it is also a common approach in practice.

Contract balances

IFRS 15 makes it clear that a single contract can only have either a contract asset or a contract liability, but never both. We believe that this requirement should be reflected in the IFRS for SMEs but whether or not this is intended is unclear from the current drafting. We therefore suggest making an explicit statement to this effect. Moreover, we believe that it would be much clearer if paragraphs 23.115 and 23.116 were redrafted in terms of the aggregate goods and services supplied under the contract, rather than the individual goods and services supplied.

AREAS WHERE WE BELIEVE ADDITIONAL SIMPLIFICATIONS SHOULD BE CONSIDERED

Transfer of a series of distinct goods and services

Paragraph 23.17 retains IFRS 15's rather strict guidance in this area. We suggest that simplifications are made to allow more freedom when applying this guidance, particularly in relation to multi-year contracts. For example, it may be helpful to introduce a practical expedient that allows entities to treat each month, quarter or year as being distinct. We note that, in practice, a similar approach may already be possible in some scenarios in which a contract includes variable consideration. However, it appears not to be possible when all the consideration in a contract is fixed.

Costs to obtain a contract

For many entities, the costs of obtaining a contract are relatively small, meaning the requirement to capitalise such costs will often be disproportionate. We therefore suggest that paragraph 23.103 is amended to allow entities an accounting policy choice between expensing and capitalising such costs. We believe that this is a better approach than the proposed undue cost or effort exemption from the requirement to capitalise such costs.

AREAS WHERE THE IFRS 15 WORDING HAS BEEN DELIBERATELY CHANGED BUT WHERE WE BELIEVE THERE WILL BE UNINTENDED NEGATIVE CONSEQUENCES

Material rights arising from extension options

When dealing with material rights arising from extension options, the proposals seems to pick up the practical alternative approach as per IFRS 15.B43, which we support. However, wrongly in our view, it then seems to state that the contract term includes the extension period. This is inconsistent with IFRS 15 and appears to be an error – but if it is deliberate, we would disagree with it. The contract term should not include the extension period – this is simply a methodology for measuring a material right. The affected paragraphs include 23.11, 23.36 and 23.42.

Customer options for additional goods and services

Paragraph 23.35 effectively prohibits treating an option as a material right unless it is significant. It also appears to prohibit material right accounting in scenarios in which amounts can become cumulatively significant, such as loyalty schemes, but are not significant in each individual transaction. This is not very helpful and is likely to make the standard more difficult to apply as an entity will need to carefully assess whether or not each item is significant. We believe it would be better to adopt the same approach as IFRS 15, which requires material right accounting where the amounts involved are expected to be significant, either individually or cumulatively, without prohibiting such accounting where amounts are not significant. In our view, such an approach would be both conceptually superior and much easier to apply in practice.

Variable consideration constraint

Paragraph 23.46 says that ‘an entity shall include in the transaction price some or all of an amount of variable consideration… only to the extent that it is highly probable that this amount will become due’. This contrasts with the equivalent wording in IFRS 15.56 which says that ‘an entity shall include in the transaction price some or all of an amount of variable consideration… only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty with the variable consideration is subsequently resolved’.

We believe that changing the words in this way may be confusing and could result in unintended consequences, as it may be possible to read the amended words as excluding the whole of a variable consideration amount unless the entire amount is highly probable to become due. We therefore recommend that the wording in paragraph 23.46 is aligned with that in IFRS 15.56.

Refund liabilities

Paragraph 23.54 makes clear that, consistent with IFRS 15, the refund liability should be measured after applying the variable consideration constraint (ie, it is a cautiously high estimate). However, the wording in the first sentence of paragraph 23.49 wrongly implies that the refund liability should be a best estimate. The words ‘the amount of consideration that the entity reasonably expects to refund to the customer’ need to be amended and aligned with paragraphs 23.53 and 23.54.

Amortisation of capitalised contract costs

The wording in paragraph 23.110 is contradictory. It requires amortisation ‘in accordance with the pattern of transfer and revenue recognition’ of the associated goods or services – but the pattern of transfer and the pattern of revenue recognition are two quite different things when the variable consideration constraint is being applied. We believe the words ‘and revenue recognition’ should be deleted.

Impairment of capitalised contract costs

Paragraph 23.113 explains that when determining the recoverable amount, the amount of consideration that the entity expects to receive is calculated by ‘adjusting the transaction price for… the effects of the customer’s credit risk’. This approach is appropriate under full IFRS where IFRS 9’s expected credit loss model is applied but does not appear to make sense under the IFRS for SMEs given that, in most cases, an incurred rather than expected loss model will be used. Moreover, without further specific guidance, it is unclear how the amount of consideration that the entity expects to receive should be adjusted for the effects of the customer’s credit risk. We therefore recommend that the reference to adjusting for credit risk is deleted.

Customers’ unexercised rights

© ICAEW 2023

Paragraph 23.120 omits the reference in IFRS 15.B46 to the variable consideration constraint. We believe it needs to be reinstated.

© ICAEW 2023