STAFF PAPER

November 2014

IASB Meeting

Project	**Comprehensive review of the *IFRS for SMEs***
Paper topic	Additional issues raised by respondents: Paper 1 (changes are being proposed by staff)

CONTACT(S)	Michelle Fisher	mfisher@ifrs.org	+44 (0) 20 7246 6918

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Objective of this paper

1. This agenda paper asks the IASB to discuss the remaining issues raised by respondents to ED/2013/9 *Proposed amendments to the IFRS for SMEs* (the ED) for which the staff are recommending changes to the requirements proposed in the ED.

2. Agenda Paper 5B contains those issues for which the staff do not recommend changes to the requirements proposed in the ED.

Structure of this paper

3. This agenda paper is set out as follows:

    (a) Organisation of the issues

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

(b) Issues in this paper:

1[1]) Accounting for income tax

2) Application of ‘undue cost or effort’

3) Definition of basic financial instruments

4) Offsetting income tax assets and liabilities

5) Accounting for extractive activities

6) Subsidiaries acquired and held for sale

7) Distribution of non-cash assets

8) Best evidence of fair value

9) Transition provisions

10) Other specific issues on requirements in the *IFRS for SMEs*

11) Consideration of IAS 32 (2009 amendment) *Classification of Rights Issues* (additional issue raised by the staff)

Note, respondents were only asked to comment on those proposed amendments on which they had concerns. Most respondents either raised no issues or only commented on a few of the proposed amendments in the ED. Less than 10 of the 57 respondents to the ED raised the concerns outlined in Issues 2-8.

(c) Appendix: Amendments to paragraph 11.9 of FRS 102 for basic financial instruments (relates to Issue 3 in this paper)

Organisation of the issues

4. The issues in this paper are set out as follows:

(a) Introduction to the issue.

(b) Summary of the main feedback received in comment letters on the ED. <u>This has been repeated and taken from Agenda Paper 15A from the May 2014 IASB meeting</u>.

(c) Staff analysis of the feedback received in comment letters on the ED.

(d) Staff recommendation.

[1] The numbering of the issues in this paper does not correspond to the numbering of the issues in the SMEIG agenda papers and report. However the titles of the issues are the same.

(e) SMEIG recommendation. Taken from the final draft of the report of recommendations of the SME Implementation Group (SMEIG).

(f) Question for the IASB to respond to.

Issue 1) Accounting for income tax (Question 2 in the ED)

(Note, the proposal to add an 'undue cost or effort' exemption for offsetting income tax assets and liabilities is addressed under Issue 4 below)

Introduction

5. When the *IFRS for SMEs* was issued in 2009, Section 29 was based on the IASB's Exposure Draft *Income Tax* (the '2009 ED'), which was issued in March 2009. However, the 2009 ED was never finalised.

6. The 2012 Request for Information (RfI) asked questions about the appropriate approach for accounting for deferred tax. Most respondents to the RfI supported retaining a temporary difference approach for SMEs and also aligning Section 29 with IAS 12 modified as appropriate to reflect the needs of SMEs and users of their financial statements. Consequently, the ED proposed to align the main recognition and measurement principles of Section 29 with IAS 12 for deferred tax.

7. When developing the ED, the staff noted it would like to explore further ways of simplifying Section 29 for SMEs. Consequently the ED asked a question seeking feedback on whether Section 29 as redrafted in the ED (referred to as Section 29 (revised)) was appropriate or whether further simplifications or guidance should be considered.

Feedback from respondents to the ED

Modifications or simplifications to the approach for income tax

8. A substantial majority of respondents who commented on Question 2 supported aligning the main recognition and measurement principles in Section 29 with IAS 12. However, about half of these respondents noted that the proposals in the ED

were too complex for SMEs and users of their financial statements and/or suggested modifications. Some of these respondents said that an SME should be permitted to apply the taxes payable approach with disclosures if it is unable to apply the requirements in Section 29 (revised) without undue cost or effort. Other respondents suggested the IASB conduct further outreach to see if SMEs would be better served and users not significantly affected by allowing an 'undue cost or effort' exemption for some or all requirements in Section 29 (revised) and to get feedback on a suitable fallback solution if that exemption is used.

Presentation and disclosure simplifications

9. A few respondents had suggestions for simplifying the presentation and disclosure requirements in Section 29 (revised):

(a) The requirement for tax consequences of transactions to be attributed to discontinued operations, other comprehensive income (OCI) or equity is often complex. Consider requiring all tax effects to be recorded as part of a single tax charge in the income statement.

(b) Australian respondents suggested consideration of the approach adopted by the Australian Accounting Standards Board (AASB) in modifying the disclosure requirements of AASB 112 *Income Taxes*, in their Reduced Disclosure Requirements. The reductions cover deferred tax disclosures about subsidiaries, joint ventures, business combinations, discontinued operations and dividends.

Other approaches for accounting for income tax

10. Some respondents who commented on Question 2 did not support aligning the main recognition and measurement principles in Section 29 with IAS 12. The following points summarise the main suggestions made by these respondents:

(a) Permit or require a taxes payable approach with disclosures.

(b) The original Section 29 is well understood in practice and should not be changed.

(c) UK respondents suggested consideration of the approach in the UK Standard FRS 102, which is based on the *IFRS for SMEs*, but provides a 'timing difference plus' approach for accounting for deferred tax.

Level of detail in Section 29

11. Most respondents were happy with the level of detail proposed in the ED. Some of these respondents commented that it was important to keep Section 29 (revised) compact and user-friendly, rather than add too much detail from IAS 12.

12. However a significant minority of respondents said Section 29 (revised) should incorporate more detail from IAS 12. The following are the main suggestions made by those respondents, with reasoning where given:

(a) Add the scope exclusion from IAS 12 for investment tax credits. These respondents believe that accounting for investment tax credits by analogy to either grants or income taxes depending on the specific facts and circumstances provides more relevant information.

(b) Add the guidance from IAS 12.30 on tax planning opportunities.

(c) Include all of the criteria in IAS 12.36 for assessing the probability that taxable profit will be available against which unused tax losses or credits can be utilised. Section 29 (revised) only has some of the criteria. These respondents argued that not including the criterion in IAS 12.36(c) requiring entities to consider whether tax losses result from identifiable causes which are unlikely to recur increases the threshold for recognising deferred tax assets, making Section 29 (revised) more restrictive than IAS 12.

(d) Add the requirement in IAS 12.51C that the presumption that the carrying amount of investment property will be recovered through sale is rebutted if the property is depreciable and held within a business model that will consume substantially all of the economic benefits of the investment over time. These respondents said that this would provide more accurate information to users of the financial statements.

(e) Include the requirements in IAS 12.68A-68C specifying the excess of the tax deduction over the related share based payment expense must be recognised in equity to prevent diversity in practice. These respondents noted SMEs may otherwise recognise the excess in profit or loss or OCI.

(f) Add disclosure in IAS 12.82 of the amount of a deferred tax asset and the nature of the evidence supporting its recognition under certain circumstances. These respondents noted that such information would be readily available and useful to users of SME financial statements.

13. A few respondents raised specific comments:

(a) Section 29 (revised) should specify that current tax assets and liabilities that include a financing transaction should be recognised on a discounted basis.

(b) Brazilian respondents requested guidance for jurisdictions where income tax is based on revenue, rather than taxable profit.

14. Some respondents recommended including a list of simplifications and other differences from IAS 12 in the Basis for Conclusions issued with the final amendments.

Staff analysis of the feedback on the ED

Undue cost and effort exemption

15. Staff note that respondents who suggested having an 'undue cost or effort' exemption for some requirements of Section 29 (revised) did not identify which requirements should be exemptible, and that the only simplified fallback solution suggested if such an exemption was used was the taxes payable approach with disclosures. The staff considered whether additional outreach should be performed on the possible use of an 'undue cost or effort' exemption, but concluded that the ED had included the relevant questions, and those responding to the ED were also those that would be expected to provide the most informed suggestions.

16. The staff note the European Financial Reporting Advisory Group (EFRAG) and the UK Financial Reporting Council (the FRC) have recently done significant work on considering ways to improve reporting of income tax (starting with the Discussion Paper *Improving the Financial Reporting of Income Tax*). This work has demonstrated that finding a more appropriate approach to that in IAS 12 would be difficult.

17. Consequently, the staff think that the only clear method that has been identified for providing relief in Section 29 (revised) is the taxes payable approach with additional disclosure if an SME is unable to apply the requirements in Section 29 (revised) without undue cost or effort. The staff has sympathy with the respondents that suggested this method because accounting for deferred tax is probably the most complex area of the *IFRS for SMEs*. However on balance the staff does not think an exemption that could lead to the taxes payable approach being applied should be added for the following reasons:

    (a) Most SMEs will have similar types of transactions year on year. Once they understand the deferred tax computations for those transactions, the accounting treatment should be relatively straightforward going forward.

    (b) In many jurisdictions IAS 12 has been applied by entities, including SMEs, for years. Consequently there is significant practical experience and education material/guidance in the public domain to assist SMEs applying Section 29 (revised).

    (c) There was significant support from respondents to both the RfI and the ED for retaining a temporary difference approach for SMEs and basing Section 29 on IAS 12. In contrast there was only limited support for other approaches, the most popular of these being the taxes payable approach.

Presentation and disclosure simplifications

18. A few respondents suggested presentation and disclosure simplifications in areas such as items recognised in OCI/equity, discontinued operations and business combinations (see paragraph 9). The staff note that the simplifications suggested

are in areas that have already been simplified from IAS 12. In addition the staff think those transactions are rarely encountered by typical SMEs, particularly those with less complex transactions. The staff also note that the existing disclosure requirements in Section 29 were reduced and simplified from both the 2009 ED and IAS 12 using the recommendations of the old SME Working Group, which undertook a comprehensive review of the disclosure proposals in the 2007 Exposure Draft of a proposed *IFRS for SMEs*. The staff is not aware of any feedback that the existing disclosures in Section 29 are causing problems in practice. Consequently, the staff do not support further simplifications in these areas.

19. For similar reasons, and with a view to limiting the disclosure requirements to those that provide key information to users of financial statements, the staff also do not support requiring an additional disclosure requirement based on IAS 12.82 (see paragraph 12(f)).

Level of detail in Section 29

20. The staff think it is important not to add excessive detail from IAS 12, especially for transactions that typical SMEs are unlikely to encounter. The staff think this is important so as not to make the *IFRS for SMEs* unduly complex for typical SMEs and to maintain consistency with the level of detail in other sections of the *IFRS for SMEs*. Consequently the staff do not support adding some of the additional guidance suggested by respondents to the ED in paragraphs 12-13. Nevertheless the staff thinks it would be helpful to add the guidance suggested by respondents in paragraphs 12(c) and (d) for the reasons given by those respondents.

21. The staff also note that not having a scope exemption for investment tax credits (see paragraph 12(a)) was an intentional difference when the *IFRS for SMEs* was drafted to provide clarity on the treatment of investment tax credits. The staff do not propose any change to this requirement in Section 29 (revised).

Staff recommendation

22. The staff recommend not adding an undue cost or effort exemption for some or all the requirements in Section 29 (revised).

23. The staff recommends only adding the following guidance to Section 29 (revised):

    (a) Include the additional criterion "whether the unused tax losses result from identifiable causes which are unlikely to recur" as a subparagraph (d) in paragraph 29.17F of Section 29 (revised). This will align the criteria for assessing the probability that taxable profit will be available against which unused tax losses or credits can be utilised with IAS 12.36.

    (b) Include in paragraph 29.21 of Section 29 (revised) the requirement in IAS 12.51C that the presumption that the carrying amount of investment property will be recovered through sale would be rebutted if the property is depreciable and held within a business model that will consume substantially all of the economic benefits of the investment over time.

24. The staff recommended moving the definition of 'substantively enacted' from the Glossary into the body of Section 29 to avoid defining a term in full IFRSs (based on comments in Issue 21 of Agenda Paper 5B).

SMEIG view on staff recommendation

The majority of SMEIG members[2] supported the staff recommendation without modification. However, a few of the SMEIG members that supported the staff recommendation made relatively minor suggestions for further modifying or redrafting one or two of the individual requirements within Section 29 (revised) that the staff will consider during balloting.

[2] Where reference is made to 'a majority of SMEIG members', this signifies between 16 and 23 of the 27 members.

A few SMEIG members[3] did not support the staff recommendation because they favour a taxes payable approach with detailed disclosure, eg disclosure of the reasons for differences between the effective tax rate and the standard tax rate. These SMEIG members think that a temporary difference approach is too complex for SMEs and users of their financial statements.

There was virtually no support expressed by SMEIG members for including an ‘undue cost or effort’ exemption from some or all the requirements in Section 29 (revised).

Question for the IASB

1) Do you agree with the staff recommendation?

Issue 2) Application of ‘undue cost or effort’ (Proposed Amendment 3 in the ED)

25. The ED proposed additional guidance on the ‘undue cost or effort’ exemption based on SMEIG Q&A 2012/01 *Application of ‘undue cost or effort’* (see paragraphs 2.14A–2.14C of the ED). The IASB proposed this amendment in response to requests from respondents to the RfI that more guidance is required to help SMEs apply the ‘undue cost or effort’ exemption in practice.

Feedback from respondents to the ED

26. The feedback in paragraphs 27-29 also covers any general comments about ‘undue cost or effort’ that respondents raised on proposed amendments 12, 17, 25 and 45 in the ED, which each proposed specific ‘undue cost or effort’ exemptions.

27. Most respondents who commented supported the additional guidance but said that it was not sufficient on its own. The following points summarise the two most common concerns:

[3] Where reference is made to ‘a few SMEIG members’, this signifies 5 or less of the 27 members

(a) The IASB should provide more guidance to prevent diversity in how the exemption is applied in practice. Some respondents asserted it is likely to be viewed as a low hurdle, almost to the extent of creating a de facto accounting policy option.

(b) An entity should be required to disclose when it has used an ‘undue cost or effort’ exemption and also disclose its reasoning for doing so. Some respondents asserted disclosure would help to control the use of the exemption and would provide useful information for users at little cost to SMEs.

28. The following are the main suggestions provided by the respondents in paragraph 27(a) for further guidance:

(a) Clearly explain the difference between 'undue cost or effort' and 'impracticable' and how the terms interact with each other. Some respondents noted that Q&A 2012/01 has guidance on this that was not included in the ED.

(b) Include a definition of ‘undue cost or effort’ in the Glossary.

(c) Clarify interaction with ‘materiality’.

(d) Include a detailed illustration of the application of ‘undue cost or effort’ in a relevant context.

29. Other suggestions included:

(a) Limit the use of ‘undue cost or effort’ exemptions. If the IASB thinks a requirement in the *IFRS for SMEs* will commonly lead to SMEs incurring costs that exceed the benefits to users of their financial statements it would be preferable to select a different accounting treatment.

(b) Extend the ‘undue cost or effort’ exemption to all requirements in the *IFRS for SMEs*. These respondents noted that the balance between benefit and cost is a qualitative characteristic of information in financial statements in Section 2 *Concepts and Pervasive Principles* of the *IFRS for SMEs*.

Staff analysis of the feedback on the ED

30. Paragraphs BC80-BC83 of the ED explain the IASB's reasoning for incorporating some of the points in SMEIG Q&A 2012/01. In particular, paragraph BC80 explains that the IASB decided not to define 'undue cost or effort' in the glossary or provide further guidance in addition to paragraphs 2.14A–2.14C of the ED because, ultimately, application of the exemption depends on the SMEs' specific circumstances and on management's judgement. The staff support this reasoning.

31. The staff think that it is difficult to provide extra guidance on the difference between 'undue cost or effort' and 'impracticable' because both terms are used in full IFRSs. Any guidance added to the *IFRS for SMEs* could be used by entities to interpret these terms under full IFRSs. Nevertheless the staff notes that some respondents said that the following clarifying sentence in SMEIG Q&A 2012/01 was not included in the proposed amendments in the ED and it would provide helpful guidance: "Applying a requirement would result in 'undue cost or effort' because of either excessive cost (eg if valuers' fees are excessive) or excessive endeavours by employees in comparison to the benefits that the expected users of the financial statements would receive from having the information." The staff agree.

32. In developing the ED the staff did not recommend to the IASB that an SME should be required to disclose when it has used an 'undue cost or effort' exemption together with its reasoning for doing so because the staff thought it would be clear from the presentation in the financial statements if an exemption had been used. The staff also had concerns that disclosure of the reasoning may be too limited to provide useful information to users of financial statements. Nevertheless the staff agree with respondents that this disclosure may help to ensure appropriate use of the exemption and it could be made at little cost to SMEs.

Staff recommendation

33. The staff recommend that the following sentence is added to paragraphs 2.14A–2.14C of the ED: “Applying a requirement would result in ‘undue cost or effort’ because of either excessive cost (eg if valuers’ fees are excessive) or excessive endeavours by employees in comparison to the benefits that the expected users of the SME’s financial statements would receive from having the information.”

34. The staff also recommend that for each ‘undue cost or effort’ exemption in the *IFRS for SMEs*, an SME should be required to disclose when it has used the exemption and disclose its reasoning for doing so.

SMEIG view on staff recommendation

The majority of SMEIG members supported the staff recommendation without modification.

However, a few SMEIG members expressed concern in the following areas:

- The additional sentence proposed by the staff is not helpful in applying the requirements and so is not necessary.

- It is still not clear how ‘impracticable’ should be differentiated from ‘undue cost or effort’.

- Requiring entities to disclose their rationale for using an ‘undue cost or effort’ exemption may not provide useful information, eg may lead to boilerplate disclosures. It is sufficient for the SME to disclose that the exemption has been used.

Question for the IASB
2) Do you agree with the staff recommendation?

Issue 3) Definition of basic financial instruments (Proposed Amendment 14 in the ED)

35. The ED clarified that foreign currency loans and loans with standard loan covenants will usually be basic financial instruments (see paragraphs 11.9(a) and

(c) of the ED). The IASB proposed this amendment after considering concerns from respondents to the RfI that these instruments do not meet the current criteria in paragraph 11.9.

Feedback from respondents to the ED

36. Respondents were predominantly either based in the UK or were global accounting firms. These respondents raised concerns that, even given the proposed changes to paragraph 11.9 in the ED, the *IFRS for SMEs* was more onerous than full IFRSs for the measurement of certain 'basic' debt instruments. They asserted that certain financial instruments that would be measured at fair value through profit or loss in accordance with Section 12 *Other Financial Instrument Issues* (because they do not meet the criteria under paragraph 11.9) would be measured at amortised cost under IFRS 9 *Financial Instruments*. Debt instruments with features such as interest rate caps or floors, stepped interest rates or certain prepayment provisions were given as examples.

37. Some of these respondents suggested that the IASB should reconsider paragraph 11.9 in its entirety to ensure that the *IFRS for SMEs* is not more onerous than full IFRS in this area. Some respondents also said that paragraph 11.9 was difficult to understand and the IASB should try and simplify the wording. Other respondents said that the IASB should consider the outcome of the ED issued by the UK FRC (FRED 54), which proposed to amend paragraph 11.9 in FRS 102[4], the UK Standard based on the *IFRS for SMEs*, to address this issue.

Staff analysis of the feedback from respondents

38. The ED proposed the following changes to paragraph 11.9 of the *IFRS for SMEs*[5]:

> 11.9 A debt instrument that satisfies all of the conditions in (a)–(d) below shall be accounted for in accordance with Section 11:

---

[4] FRS 102 is based on the *IFRS for SMEs*, but there are significant differences between the two standards in some areas.

[5] New text proposed by the ED is underlined and deleted text proposed by the ED is struck through.

(a) Returns to the holder (the lender) assessed in the currency in which the debt instrument is denominated are:

(i) a fixed amount;

(ii) a fixed rate of return over the life of the instrument;

(iii) a variable return that, throughout the life of the instrument, is equal to a single referenced quoted or observable interest rate (such as LIBOR); or

(iv) some combination of such fixed rate and variable rates (such as LIBOR plus 200 basis points), provided that the sum of ~~both~~ the fixed and variable rates are positive (eg an interest rate swap with a positive fixed rate and negative variable rate would not meet this criterion). For fixed and variable rate interest returns, interest is calculated by multiplying the rate for the applicable period by the principal amount outstanding during the period.

(b) There is no contractual provision that could, by its terms, result in the holder (the lender) losing the principal amount or any interest attributable to the current period or prior periods. The fact that a debt instrument is subordinated to other debt instruments is not an example of such a contractual provision.

(c) Contractual provisions that permit the issuer (the borrower ~~debtor~~) to prepay a debt instrument or permit the holder (the lender ~~creditor~~) to put it back to the issuer before maturity are not contingent on future events other than to protect:

(i) the holder against the credit deterioration of the issuer (for example, defaults, credit downgrades or loan covenant violations), or a change in control of the issuer, or

(ii) the holder or issuer against changes in relevant taxation or law.

(d) There are no conditional returns or repayment provisions except for the variable rate return described in (a) and prepayment provisions described in (c).

39. Other than concerns about the complexity of paragraph 11.9, the concerns in paragraphs 36-37 appear to have been raised by respondents as a result of feedback from entities in the UK. The staff has not had similar feedback from other jurisdictions that paragraph 11.9 has, or is likely to, result in debt instruments held by typical SMEs being measured at fair value. Furthermore the staff note that in the UK certain financial institutions are permitted to apply FRS 102 and such entities are more likely to have complex debt instruments than typical SMEs considered by the IASB. Nevertheless, the staff note that concerns do not solely relate to entities outside the intended scope of the *IFRS for SMEs*.

40. Some respondents said that the IASB should consider the outcome of FRED 54 issued by the UK FRC (see paragraph 37). The final amendments to FRS 102, following exposure of FRED 54, were issued in July 2014. However, other respondents to the ED said that paragraph 11.9 should be simplified and the staff think the revised wording in FRS 102 would add further complexity to Section 11 by adding additional criteria to paragraph 11.9.

41. The changes to paragraph 11.9 in FRS 102 are shown in the appendix to this agenda paper. For IASB members wishing to see the full amendments to FRS 102 relating to financial instruments, including changes to hedging requirements they can be accessed here:

https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Amendments-to-FRS-102-The-Financial-Reporting-Stan-File.pdf.

42. As noted above the staff think that this appears to be an issue that has arisen primarily related to UK entities in the scope of FRS 102. Further, the staff continues to think that only a very limited number of typical SMEs are likely to have loans that do not meet the current criteria in paragraph 11.9 of the ED. Nevertheless the staff would like to flag the following points for the IASB consideration:

(a) Other than debt instruments with features such as interest rate caps or floors, stepped interest rates or certain prepayment provisions that were given as examples by respondents to the ED (see paragraph 36), the staff have also heard outside the ED process that there are some concerns by interested parties in the UK that the following types of loans may not meet the criteria in paragraph 11.9 in the ED — loans with terms permitting mandatory cost adjustments, changes in interest rates due to taxation and law changes, and negative interest rates. The staff agree that loans with some of these conditions might fail the criteria in paragraph 11.9 of the ED. However, the staff has not had feedback from jurisdictions outside the UK that in practice debt instruments held by typical SMEs are likely to fail the criteria in paragraph 11.9 of the ED. Nevertheless, the staff thinks that certain basic loans with stepped interest rates could be common amongst typical SMEs, eg a five year fixed rate loan with an initial interest free period. The staff think that the criteria in paragraph 11.9(a) of the ED is intended to cover this type of loan, but can see how this may not be clear from a strict reading of paragraph 11.9(a).

(b) The amendments to FRS 102 will include a number of illustrative examples of 'basic' instruments that meet the amended criteria in paragraph 11.9 in FRS 102 (see appendix). The staff have identified one example that may not clearly meet the criteria in paragraph 11.9 of the ED (see paragraph 38) which the staff agree is likely to be a loan held by a typical SMEs. This example is a fixed interest rate loan with an initial tie-in period which reverts to the bank's standard variable interest rate after the tie-in period. As noted in paragraph 42(a), once again the staff think that the criteria in paragraph 11.9(a) of the ED is intended to cover this type of loan, but can see how this may not be clear from a strict reading of paragraph 11.9(a).

SMEIG view (note this was expressed based on staff papers written before the final amendment to FRS 102 was issued)

The majority of SMEIG members thought that the IASB should consider the amendments to FRS 102 and discuss whether to include some or all of the modified criteria in the *IFRS for SMEs*. However, when doing so, the SMEIG think the IASB should be mindful that it does not complicate the *IFRS for SMEs* unnecessarily if this issue is not widespread.

Nearly all SMEIG members[6] said they we not aware of any concerns in their jurisdiction that paragraph 11.9 has resulted in/is likely to result in any debt instruments commonly held by SMEs being measured at fair value, rather than cost/amortised cost?

Only one SMEIG member expressed concern about a specific type of financial instrument. This SMEIG member noted that he could see how provisions such as interest rate floors or stepped interest rates would potentially disqualify a debt instrument from the amortised cost model and that the IASB should address this.

[6] Where reference is made to 'nearly all SMEIG members' in this report, this signifies 24 or more of the 27 members.

However a few SMEIG members did not support consideration of the amendments to paragraph 11.9 of FRS 102 because they thought it would make the criteria in paragraph 11.9 too complex.

Staff recommendation (updated after SMEIG papers were prepared due to the finalisation of the amendments to FRS 102 and so not commented on by the SMEIG)

43. The staff recommend paragraph 11.9(a)(iv) in the ED is amended as follows to clarify that basic loans with stepped interest rates/stated changes in interest rate during the loan period are 'basic' financial instruments in the scope of Section 11:

(iv) some combination of such fixed rate and variable rates (<u>eg a loan provided at</u> ~~such as~~ LIBOR plus 200 basis points <u>or a fixed interest rate loan with an initial tie-in period which reverts to the bank's standard variable interest rate or a different fixed interest rate after the initial tie-in period</u>), provided that <u>the sum of</u> ~~both~~ the fixed and variable rates are positive (eg an interest rate swap with a positive fixed rate and negative variable rate would not meet this criterion). For fixed and variable rate interest returns, interest is calculated by multiplying the rate for the applicable period by the principal amount outstanding during the period.

Question for the IASB
3) Do you agree with the staff recommendation?

Issue 4) Offsetting income tax assets and liabilities (Proposed Amendment 45 in the ED)

44. The ED proposed addition of an 'undue cost or effort' exemption to the requirement to offset income tax assets and liabilities (see paragraph 29.29 of the ED). The IASB proposed this amendment to clarify that offsetting income tax assets and liabilities would not be required if significant, detailed scheduling is required. The exemption is intended to provide similar relief to IAS 12 without including the more complex wording used in IAS 12.

Feedback from respondents to the ED

45. Respondents said that an entity should be required to offset deferred tax assets and liabilities if they are related to income taxes levied by the same taxation authority on the same taxable entity (a requirement from IAS 12.74(b)(i)). Other

respondents said the wording "it is evident without undue cost or effort that it intends" is unclear and should be clarified. Some of these respondents said that the full wording in IAS 12.71 and 12.74 should be used instead.

Staff analysis of the feedback on the ED

46. The ED proposed the following changes to paragraphs 29.29 of the *IFRS for SMEs*:

29.29 An entity shall offset current tax assets and current tax liabilities, or offset deferred tax assets and deferred tax liabilities, only when it has a legally enforceable right to set off the amounts and <u>it is evident without undue cost or effort that</u> it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

47. Paragraph 29.29 addresses offsetting of both current and deferred tax. IAS 12 has separate requirements for offsetting deferred tax assets and liabilities to avoid the need for detailed scheduling. IAS 12.71 and 12.74 provide the requirements for offsetting current tax assets/liabilities and deferred tax assets/liabilities under full IFRS (black letter paragraphs):

IAS 12.71 An entity shall offset current tax assets and current tax liabilities if, and only if, the entity:

(a) has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

IAS 12.74 An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:

(a) the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and

(b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:

(i) the same taxable entity; or

(ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

48. The staff think 'if, and only if' (used in IAS 12.71) may have been replaced by 'only when' in paragraph 29.29 of the *IFRS for SMEs* with the intention of permitting rather than requiring offset if the conditions in paragraph 29.29 were met. This would thus provide relief from the need for detailed scheduling that would be required in rare cases under IAS 12.

49. Nevertheless, respondents to the RfI said that it is not clear there is any relief in paragraph 29.29. Consequently, the ED proposed to add an 'undue cost or effort'

exemption. In light of the wording being perceived as unclear and the addition of the 'undue cost or effort' exemption, the staff think it would be better to use "if, and only if," like IAS 12.71. This change would more closely align paragraph 29.29 with IAS 12 by ensuring offset is required if the appropriate conditions are met, unless to do so would result in undue cost or effort. This would respond to concerns raised by respondents that an entity should be required to offset deferred tax assets and liabilities if they are related to income taxes levied by the same taxation authority on the same taxable entity.

50. The staff also suggest changing the wording 'it is evident' to 'the entity can show' to respond to concerns that the proposed wording in paragraph 29.29 of the ED is unclear.

Staff recommendation[7]

51. The staff recommend paragraph 29.29 of the *IFRS for SMEs* should instead be amended as follows:

> 29.29 An entity shall offset current tax assets and current tax liabilities, or offset deferred tax assets and deferred tax liabilities <u>if, and</u> only <u>if</u> ~~when~~ it has a legally enforceable right to set off the amounts and <u>the entity can show without undue cost or effort that</u> it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

SMEIG view on staff recommendation

The majority of SMEIG members supported the staff recommendation without modification.

However a significant minority of SMEIG members[8] expressed concern about the rewording of paragraph 29.29 proposed by the staff. A few of these SMEIG members agreed with keeping the 'undue cost or effort' exemption, but thought that the wording was ambiguous. These SMEIG members suggested ways the staff could redraft the requirement, eg replacing 'entity can show' with 'entity can document'. However other SMEIG members said the wording in IAS 12

[7] New text being proposed is underlined and deleted text being proposed is struck through

[8] Where reference is made to 'a significant minority of SMEIG members', this signifies between 6 and 11 of the 27 members.

(paragraphs 71 and 74 of IAS 12) should be used instead of having an 'undue cost or effort' exemption.

Question for the IASB
4) Do you agree with the staff recommendation?

Issue 5) Accounting for extractive activities (Proposed Amendment 49 in the ED)

52. The ED proposed clarification of the accounting requirements for extractive activities (see paragraphs 34.11–34.11A of the ED). The IASB proposed this amendment in response to requests by respondents to the RfI that the accounting requirements for SMEs involved in extractive activities needed to be clarified.

Feedback from respondents to the ED

53. Most respondents asserted that the proposed requirements were more onerous than the related requirements in full IFRSs. These respondents noted that paragraph 7 of IFRS 6 *Exploration for and Evaluation of Mineral Resources* exempts an SME under full IFRSs from paragraphs 11-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when developing accounting policies for the recognition and measurement of exploration and evaluation assets. These respondents observed that paragraph 34.11 of the ED would require an entity to determine an accounting policy in accordance with the accounting policy hierarchy in paragraphs 10.4-10.6 of the *IFRS for SMEs*, which would require an entity to consider the concepts and principles in Section 2. Respondents suggested providing a similar exemption to full IFRSs in paragraph 34.11.

54. A few respondents said specific guidance should be provided for accounting for impairment of exploration and evaluation assets, rather than requiring entities to follow the general requirements in Section 27 *Impairment of Assets*. Respondents asserted that developing specific guidance for impairment of exploration and evaluation assets was an important issue in IFRS 6.

Staff analysis of the feedback on the ED

55. The ED proposed the following changes to paragraphs 34.11 of the *IFRS for SMEs* and the addition of a new paragraph 34.11A:

> 34.11 An entity using this IFRS that is engaged in the exploration for, and evaluation ~~or extraction~~ of, mineral resources ~~(extractive activities)~~ shall determine an accounting policy that specifies which expenditures are recognised as exploration and evaluation assets in accordance with paragraphs 10.4-10.6 in Section 10 *Accounting Policies, Estimates and Errors* and shall apply the policy consistently. Expenditures related to the development of mineral resources shall not be recognised as exploration and evaluation assets. ~~account for expenditure on the acquisition or development of tangible or intangible assets for use in extractive activities by applying Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*, respectively. When an entity has an obligation to dismantle or remove an item, or to restore the site, such obligations and costs are accounted for in accordance with Section 17 and Section 21 *Provisions and Contingencies*.~~
>
> 34.11A Exploration and evaluation assets shall be measured on initial recognition at cost. After recognition, an entity shall apply Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets* to the exploration and evaluation assets according to the nature of the assets acquired. If an entity has an obligation to dismantle or remove an item, or to restore the site, such obligations and costs are accounted for in accordance with Section 17 and Section 21 *Provisions and Contingencies*.

56. The proposed changes to paragraph 34.11 in the ED explicitly require SMEs to determine their accounting policy for the exploration for and evaluation of mineral resources in accordance with paragraphs 10.4-10.6 in Section 10. Paragraph 10.4 requires management to use its judgement in developing an accounting policy when the *IFRS for SMEs* does not specifically address a transaction, event or other condition. Paragraph 10.5 requires management to firstly consider other requirements and guidance in the *IFRS for SMEs* dealing with similar and related issues and secondly consider Section 2 *Concepts and Pervasive Principles*. Paragraph 10.6 permits management to look to full IFRSs if those requirements in full IFRSs do not conflict with paragraph 10.4-10.5.

57. The staff do not think it was the IASB’s intention to create requirements in the *IFRS for SMEs* that are stricter than IFRS 6. Consequently, in line with IFRS 6.7, the staff think an SME should be exempt from applying paragraph 10.5 to its accounting policies for the recognition and measurement of exploration and evaluation assets for the reasoning in IFRS 6 (see IFRS 6.BC2-BC3).

58. The staff also agree that the impairment requirements in Section 27 may be more onerous for some SMEs than those in IFRS 6. Consequently the staff suggest including the requirements in IFRS 6.18-22. When incorporating IFRS 6.21 the

staff have omitted the requirement "Each cash-generating unit or group of units to which an exploration and evaluation asset is allocated shall not be larger than an operating segment determined in accordance with IFRS 8 *Operating Segments*.". This is because the *IFRS for SMEs* does not have similar requirements to IFRS 8 and does not define an operating segment.

59. The staff think it would be better to include specific requirements in the *IFRS for SMEs* than require SMEs to refer to IFRS 6. The *IFRS for SMEs* is intended to be a standalone Standard. There is currently only one fallback to full IFRSs in the *IFRS for SMEs* and this is for financial instruments. The fallback is optional and was provided for specific reasons. The staff think that the IASB should remove that fallback in the future once the completed IFRS 9 has been considered. Consequently the staff do not suggest creating another fallback to full IFRSs.

Staff recommendation

60. The staff recommend paragraph 34.11 of the *IFRS for SMEs* should be amended and new paragraphs 34.11A-G should be added as follows:

34.11 An entity using this IFRS that is engaged in the exploration for, and evaluation ~~or extraction~~ of, mineral resources ~~(extractive activities)~~ shall determine an accounting policy that specifies which expenditures are recognised as exploration and evaluation assets in accordance with paragraph 10.4 in Section 10 *Accounting Policies, Estimates and Errors* and shall apply the policy consistently. An entity is exempt from applying paragraph 10.5 in Section 10 to its accounting policies for the recognition and measurement of exploration and evaluation assets.

34.11A Exploration and evaluation assets shall be measured on initial recognition at cost ~~account for expenditure on the acquisition or development of tangible or intangible assets for use in extractive activities by applying Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*, respectively. When an entity has an obligation to dismantle or remove an item, or to restore the site, such obligations and costs are accounted for in accordance with Section 17 and Section 21 *Provisions and Contingencies*.~~

34.11B An entity shall determine an accounting policy specifying which expenditures are recognised as exploration and evaluation assets and apply the policy consistently. In making this determination, an entity considers the degree to which the expenditure can be associated with finding specific mineral resources. The following are examples of expenditures that might be included in the initial measurement of exploration and evaluation assets (the list is not exhaustive):

(a) acquisition of rights to explore;

(b) topographical, geological, geochemical and geophysical studies

(c) exploratory drilling

(d) trenching

(e) sampling; and

(f) activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

Expenditures related to the development of mineral resources shall not be recognised as exploration and evaluation assets.

34.11C If an entity has an obligation to dismantle or remove an item, or to restore the site, such obligations and costs are accounted for in accordance with Section 17 and Section 21 *Provisions and Contingencies*.

34.11D Exploration and evaluation assets shall be assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. An entity shall measure, present and disclose any resulting impairment loss in accordance with Section 27, except as provided by paragraph 34.11G.

34.11E For the purposes of exploration and evaluation assets only, paragraph 34.11F shall be applied rather than paragraphs 27.7-27.10 when identifying an exploration and evaluation asset that may be impaired. Paragraph 34.11F uses the term 'assets' but applies equally to separate exploration and evaluation assets or a cash-generating unit.

34.11F One or more of the following facts and circumstances indicate that an entity should test exploration and evaluation assets for impairment (the list is not exhaustive):

(a) the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed.

(b) substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned.

(c) exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area.

(d) sufficient data exist to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale

The entity shall perform an impairment test, and recognise any impairment loss, in accordance with Section 27.

34.11G An entity shall determine an accounting policy for allocating exploration and evaluation assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment.

61. The staff think that their recommendation in paragraph 60 is consistent with the requirements in IFRS 6. Consequently, the staff think an SME would be able to apply IFRS 6 in full by applying paragraphs 34.11-34.11G above and paragraph 10.6, should it wish to do so, and be able to state compliance with the *IFRS for SMEs*.

SMEIG view on staff recommendation

Nearly all SMEIG members supported the staff recommendation without modification.

However, a few SMEIG members expressed concern that the staff recommendation would lead to requirements that were too long and complex for SMEs.

Question for the IASB

5) Do you agree with the staff recommendation?

Issue 6) Subsidiaries acquired and held for sale (Proposed Amendment 8 in the ED)

62. The ED proposed to clarify that all subsidiaries acquired with the intention of sale or disposal within one year should be excluded from consolidation (see paragraphs 9.3–9.3A of the ED). The IASB proposed this amendment to clarify the wording in paragraph 9.3 to avoid misunderstanding and ensure it is applied appropriately.

Feedback from respondents to the ED

63. Respondents were concerned that the requirements were unclear on:

    (a) whether the time frame of one year begins from the date of acquisition or from the reporting date; and

    (b) how to account for the subsidiary if the parent changes its intentions or if the subsidiary is otherwise not sold or disposed of within one year.

64. A few respondents proposed a requirement to disclose unconsolidated subsidiaries.

Staff analysis of the feedback on the ED

65. The ED proposed the following changes to paragraphs 9.2-9.3 of the *IFRS for SMEs* and the addition of a new paragraph 9.3A:

    9.2 Except as permitted or required by paragraphs 9.3–9.3A, a **parent** entity shall present consolidated financial statements in which it consolidates its investments in **subsidiaries** ~~in accordance with this IFRS~~. Consolidated financial statements shall include all subsidiaries of the parent.

    9.3 A parent need not present consolidated financial statements if~~: (a)~~ both of the following conditions are met:

    (~~i~~a) the parent is itself a subsidiary, and

    (~~ii~~b) its ultimate parent (or any intermediate parent) produces consolidated **general purpose financial statements** that comply with **full IFRSs** or with this IFRS. ~~; or~~

    ~~(b) it has no subsidiaries other than one that was acquired with the intention of selling or disposing of it within one year. A parent shall account for such a subsidiary:~~

(i) ~~at fair value with changes in fair value recognised in profit or loss, if the fair value of the shares can be measured reliably, or~~

(ii) ~~otherwise at cost less impairment (see paragraph 11.14(c)).~~

9.3A A subsidiary shall be excluded from consolidation if it was acquired with the intention of selling or disposing of it within one year. A parent shall account for such a subsidiary:

(a) at fair value, with changes in fair value recognised in profit or loss, if the fair value of the shares can be measured reliably (see paragraphs 11.27–11.32); or

(b) at cost less impairment if the fair value of the shares cannot be measured reliably (see paragraphs 11.21–11.26).

If a parent entity has no subsidiaries other than subsidiaries acquired with the intention of selling or disposing of them within one year, it does not present consolidated financial statements.

66. The staff think the statement "…if it was acquired with the intention of selling or disposing of it within one year…" in paragraph 9.3A is clear that the time frame of one year begins from the date of acquisition. Consequently the staff do not think this needs to be clarified further. However the staff agree with the respondents that said Section 9 is unclear on how to account for the subsidiary if the parent changes its intentions or the subsidiary is not sold. Consequently the staff think guidance should be added to address this. The staff think that the subsidiary should be consolidated from the date of acquisition. Such a requirement is unlikely to be onerous because the date of acquisition would have been in the last twelve months. The staff note that if the parent changes its intention to sell the subsidiary in the same reporting period as its acquisition, or before the financial statements for the same reporting period have been authorised (adjusting event), there would be no need to restate any prior year information.

67. The staff do not think that an SME should be required to disclose unconsolidated subsidiaries. There are currently no requirements to disclose a list of subsidiaries, associates or joint ventures in the *IFRS for SMEs* (see Issue 22 of Agenda Paper 5B). However, the staff think that if subsidiaries are accounted for like investments in equity instruments, the disclosures in Section 11 should apply.

Staff recommendation

68. The staff recommend revising paragraph 9.3A of the ED and adding two new paragraphs 9.3B and 9.3C as follows:

9.3A A subsidiary shall be excluded from consolidation if it was acquired with the intention of selling or disposing of it within one year. A parent shall account for such a subsidiary:

(a) at fair value, with changes in fair value recognised in profit or loss, if the fair value of the shares can be measured reliably (see paragraphs 11.27–11.32); or

(b) at cost less impairment if the fair value of the shares cannot be measured reliably (see paragraphs 11.21–11.26).

An entity shall provide the disclosures required in Section 11 for any such subsidiaries.

9.3B If a parent entity has no subsidiaries other than subsidiaries acquired with the intention of selling or disposing of them within one year, it does not present consolidated financial statements.

9.3C If a subsidiary previously excluded from consolidation in accordance with paragraph 9.3A is not disposed of within twelve months:

(a) the parent shall consolidate the subsidiary from the acquisition date unless it meets the conditions in (b). Consequently, if acquisition took place in a prior period, that prior period is restated.

(b) If the parent has found a buyer for the subsidiary, the sale is in process at the reporting date, and it is expected to be completed shortly after the reporting date the parent shall continue to account for such a subsidiary in accordance with paragraph 9.3A.

69. The staff recommend no changes to the proposed amendments to paragraphs 9.2 and 9.3 in the ED (see paragraph 65).

SMEIG view on staff recommendation

The majority of SMEIG members supported the staff recommendation without modification.

However, a few SMEIG members said that it was important to clarify the timeframe because it is not clear whether the period of 12 months begins on the date of acquisition or on the reporting date.

A few SMEIG members noted that the requirements in paragraph 9.3C are only likely to be applicable to SMEs in rare cases and the approach would be expected to be clear without the added text. These SMEIG members suggest deleting paragraph 9.3C.

A few SMEIG members thought that SMEs should be required to disclose any subsidiaries that are not consolidated.

A few SMEIG members supported removing the exemption in paragraphs 9.3A-C altogether, thereby requiring all subsidiaries acquired and held for sale to be consolidated.

Question for the IASB

6) Do you agree with the staff recommendation?

Issue 7) Distribution of non-cash assets (Proposed Amendment 34 in the ED)

70. The ED proposed to add guidance on accounting for the settlement of a distribution of non-cash assets (see paragraph 22.18 of the ED). The IASB proposed this amendment to make the requirements clearer, and hence easier to apply.

Feedback from respondents to the ED

71. Respondents had concerns that requiring the liability to be measured at the fair value of the assets distributed added unnecessary complexity. Respondents either suggested the IASB remained silent or added an 'undue cost or effort' exemption from fair value measurement.

Staff analysis of the feedback on the ED

72. The ED proposed the following changes to paragraphs 22.18 of the *IFRS for SMEs*:

> 22.18 Sometimes an entity distributes assets other than cash ~~as dividends~~ to its owners (<u>'non-cash dividends'</u>). When an entity declares such a distribution and has an obligation to distribute non-cash assets to its owners, it shall recognise a liability. It shall measure the liability at the fair value of the assets to be distributed. At the end of each **reporting period** and at the date of settlement, the entity shall review and adjust the carrying amount of the dividend payable to reflect changes in the fair value of the assets to be distributed, with any changes recognised in equity as adjustments to the amount of the distribution. <u>When an entity settles the dividend payable, it shall recognise any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable in profit or loss.</u>

73. The concerns raised by respondents relate to existing requirements in paragraph 22.18, not the changes proposed by the ED. Nevertheless, the staff agree that there may be instances where fair value is difficult to determine, eg distributions of certain intangible assets or unquoted equity instruments to owners. The staff also thinks that adding an 'undue cost or effort' exemption to paragraph 22.18 would be consistent with having 'undue cost or effort' exemptions in the *IFRS for SMEs* for the measurement of the types of non-cash assets that may be distributed—for

example exemptions from fair value measurements for investments in equity instruments (proposal in the ED) or investment property (existing requirement) where measurement causes undue cost or effort.

74. The staff note that distributions of non-cash assets to owners are related party transactions and so the disclosure requirements in Section 33 *Related Party Disclosures* would apply. The staff also note that the staff recommendation for Issue 2 (see paragraph 34) is that an SME should be required to disclose when it has used an 'undue cost or effort' exemption and its reasoning for doing so. The staff think the information provided to satisfy these disclosures is sufficient for users of the SME financial statements, taking into account cost-benefit considerations.

Staff recommendation

75. The staff recommend paragraph 22.18 of the *IFRS for SMEs* should be amended and a new paragraph 22.18AA should be added as follows:

22.18 Sometimes an entity distributes assets other than cash ~~as dividends~~ to its owners <u>('non-cash dividends')</u>. When an entity declares such a distribution and has an obligation to distribute non-cash assets to its owners, it shall recognise a liability. It shall measure the liability at the fair value of the assets to be distributed <u>unless it meets the conditions in paragraph 22.18AA</u>. At the end of each **reporting period** and at the date of settlement, the entity shall review and adjust the carrying amount of the dividend payable to reflect changes in the fair value of the assets to be distributed, with any changes recognised in equity as adjustments to the amount of the distribution. <u>When an entity settles the dividend payable, it shall recognise any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable in profit or loss.</u>

<u>22.18AA If the fair value of the assets to be distributed cannot be measured reliably without undue cost or effort, the liability shall be measured at the carrying amount of the assets to be distributed. If at a later date the fair value of the assets to be distributed can be measured without undue cost or effort, the liability is measured in accordance with paragraph 22.18. If the fair value of the assets to be distributed cannot be measured without undue cost or effort, the entity shall state that fact and explain why.</u>

SMEIG view on staff recommendation

The majority of SMEIG members supported the staff recommendation without modification.

However, a few SMEIG members disagreed with adding paragraph 22.18AA which permits an 'undue cost or effort' exemption. The following were the main reasons given:

- SMEs would be expected to be aware of the value of the assets they distribute.

- Users of SME financial statements would want to know the value of any assets distributed.

- Such distributions are likely to be rare for SMEs and so specific guidance is not necessary.

Question for the IASB
7) Do you agree with the staff recommendation?

Issue 8) Best evidence of fair value (Proposed Amendment 15 in the ED)

76. The ED proposed to clarify in the guidance on fair value measurement that the best evidence of fair value may be a price in a binding sale agreement (see paragraph 11.27 of the ED). The wording used is consistent with the wording used in Section 27 *Impairment of Assets* (paragraph 27.14 of the *IFRS for SMEs*). The guidance in paragraph 11.27 applies to fair value measurements of assets in other Sections and not just financial instruments in the scope of Sections 11-12.

Feedback from respondents to the ED

77. Respondents said the term 'binding sale agreement' needed to be explained, eg by providing an indication of how recently the binding sale agreement was made and whether it would be considered if there was a quoted price for an identical asset in an active market.

Staff analysis of the feedback on the ED

78. The ED proposed the following changes to paragraph 11.27 of the *IFRS for SMEs*:

11.27 Paragraph 11.14(c)(i) requires an investment in ordinary shares or preference shares to be measured at fair value if the fair value of the shares can be measured reliably <u>without undue cost or effort</u>. An entity shall use the following hierarchy to estimate the fair value of the shares:

(a) The best evidence of fair value is <u>a price in a binding sale agreement in an arm's length transaction or</u> a quoted price for an identical asset in an active market <u>(the latter</u> ~~This~~ is usually the current bid price<u>)</u>.

(b) If there is no binding sale agreement or active market for the asset ~~When quoted prices are unavailable~~, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant period ~~lapse~~ of time since the transaction took place. If the entity can demonstrate that the last transaction price is not a good estimate of fair value (eg because it reflects the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted.

(c) If there is no binding sale agreement or active market for the asset ~~If the market for the asset is not active~~ and recent transactions of an identical asset on their own are not a good estimate of fair value, an entity estimates the fair value by using ~~a~~ another valuation technique. The objective of using a valuation technique is to estimate what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

Other sections of this IFRS make reference to the fair value guidance in paragraphs 11.27–11.32, including Section 9, Section 12, Section 14, Section 15, ~~and~~ Section 16 *Investment Property* and Section 28. In applying that guidance to assets covered by those sections, the reference to ordinary shares or preference shares in this paragraph should be read to include the types of assets covered by those sections.

79. The staff think the guidance "a price in a binding sale agreement in an arm's length transaction" in paragraph 11.27 of the ED is helpful because it may be the only objective evidence of fair value for some assets held by SMEs. Nevertheless, the staff think it may be better to move the guidance from paragraph 11.27(a) to paragraph 11.27(b) because a quoted price for an identical asset in an active market is nearly always the best evidence of fair value.

80. A price in a binding sale agreement may be entered into some time before or after the year end. Therefore, the price may need to be adjusted for changes in economic circumstances. Consequently the staff think that guidance on binding sale agreements can be incorporated with the guidance on recent transactions, because the adjustments and considerations are likely to be similar.

81. The term 'binding sale agreement' is used in full IFRSs. Consequently the staff do not think a definition should be provided. Otherwise any guidance added to the *IFRS for SMEs* could be used by entities to interpret this term under full IFRSs.

Staff recommendation

82. The staff recommend paragraph 11.27 of the *IFRS for SMEs* should instead be amended as follows:

11.27 Paragraph 11.14(c)(i) requires an investment in ordinary shares or preference shares to be measured at fair value if the fair value of the shares can be measured reliably without undue cost or effort. An entity shall use the following hierarchy to estimate the fair value of the shares:

(a) The best evidence of fair value is a quoted price for an identical asset in an active market. This is usually the current bid price.

(b) When quoted prices are unavailable, a price in a binding sale agreement for the asset or the price of a recent transaction for an identical asset provides evidence of fair value. However these prices may not be a good estimate of fair value if there has ~~as long as there has not~~ been a significant change in economic circumstances or a significant period ~~lapse~~ of time between ~~since~~ the time of the agreement or the transaction and the period end ~~took place~~. If the entity can demonstrate that the last transaction price is not a good estimate of fair value (eg because it reflects the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted.

(c) If the market for the asset is not active, there is no binding sale agreement and recent transactions of an identical asset on their own are not a good estimate of fair value, an entity estimates the fair value by using ~~a~~ another valuation technique. The objective of using a valuation technique is to estimate what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

Other sections of this IFRS make reference to the fair value guidance in paragraphs 11.27–11.32, including Section 9, Section 12, Section 14, Section 15, ~~and~~ Section 16 *Investment Property* and Section 28. In applying that guidance to assets covered by those sections, the reference to ordinary shares or preference shares in this paragraph should be read to include the types of assets covered by those sections.

SMEIG view on staff recommendation

The majority of SMEIG members agreed with the staff recommendation without modification.

A few SMEIG members suggested relatively minor drafting changes to the staff's recommended wording.

Question for the IASB

8) Do you agree with the staff recommendation?

Issue 9 Transition provisions (Question 5 of the ED)

83. The ED proposed that the proposed amendments to the *IFRS for SMEs* in Sections 2–34 of the ED should be applied retrospectively. This is because the IASB had observed that it did not expect any of the proposed amendments to be significantly burdensome for SMEs to apply retrospectively.

Feedback from respondents to the ED

84. A majority of respondents that commented on Question 5 supported the transition provisions without modification. Most of these respondents did not provide any further comments. The following points summarise the main comments made in support of the transition provisions:

    (a) Retrospective application would not be a significant burden for SMEs because most of the proposed amendments are minor and are unlikely to have a significant impact on SME reporting.

    (b) Retrospective application would provide the most comparable and useful information for users of the financial statements.

    (c) Some respondents noted that they only supported retrospective application on the basis that the IASB had said that the proposed amendments would not be burdensome to implement. They noted if it turned out that this was not the case for any of the proposed amendments, prospective application should be permitted.

85. A significant minority of respondents that commented on Question 5 did not support the transition provisions. Approximately half of these disagreed because they thought that retrospective application of the proposed amendments to Section 29 *Income Taxes* would be burdensome —some observing that SMEs will need to consider the effect of each individual change to the requirements for recognising, measuring and disclosing deferred tax. Other respondents said that some of the other proposed amendments may also be costly to apply retrospectively and they did not think the benefits of restated information would justify incurring significant costs. The following points summarise the main suggestions made by respondents:

    (a) Allow prospective application of the proposed amendments to Section 29 or of all proposed amendments.

    (b) Allow an 'undue cost or effort' exemption from the retrospective application of individual proposed amendments.

(c) Allow prospective application of the proposed amendments but require note disclosure of the impact of the changes on the financial statements

(d) If a proposed amendment is based on a similar amendment to full IFRS that was applied prospectively, it should be applied prospectively by SMEs as well.

86. Approximately half of respondents in jurisdictions that have adopted the *IFRS for SMEs* said that full retrospective application of the proposed amendments would be too costly.

Staff analysis of the feedback on the ED

87. The ED proposed to add the following paragraph to the *IFRS for SMEs*:

> A1 Amendments to the *IFRS for SMEs*, issued in [date], amended paragraphs XXX and the glossary of terms; added paragraphs XXX; and deleted paragraphs XXX. An entity shall apply those paragraphs for annual periods beginning on or after [date]. Amendments to Sections 2–34 shall be applied retrospectively in accordance with Section 10 *Accounting Policies, Estimates and Errors*. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

Proposed amendments to Section 29

88. Like IAS 12, Section 29 of the *IFRS for SMEs* currently requires SMEs to recognise deferred tax using the temporary difference approach. Consequently, the staff think most SMEs will find the proposed amendments to Section 29, which align the main requirements with IAS 12, will not significantly affect the amounts they recognise for deferred tax. Furthermore, because of the additional exemptions included in Section 29 (revised) in the ED compared to Section 29 in the *IFRS for SMEs*, some SMEs may find that deferred tax arises on fewer assets and liabilities, meaning fewer deferred tax calculations are required.

89. Nevertheless the staff acknowledge that much of the wording in Section 29 has been revised significantly in the ED. SMEs will need to consider the effect of all of the individual changes to the requirements for recognising and measuring deferred tax based on their own particular circumstances. To determine how all these individual changes applied retrospectively would affect the financial statements may be time consuming and complex for some SMEs.

90. As noted in paragraph 88, the staff think the proposed amendments to Section 29 will not significantly affect the amounts most SMEs recognise for deferred tax. Furthermore, the ED only proposes minor changes to the disclosure requirements in Section 29. Consequently the staff think the impact of the proposed amendments to Section 29 on the information in the financial statements will be limited for most SMEs. As a result the staff think allowing SMEs to apply the proposed amendments to Section 29 prospectively is supported by cost benefit reasons, ie the staff think the costs of requiring SMEs to apply the amendments to Section 29 retrospectively could exceed the benefits to users of their financial statements.

Proposed amendments to other sections

91. Section 35 *Transition to the IFRS for SMEs* does not require first time adopters to retrospectively apply requirements in the *IFRS for SMEs* if it would be impracticable (paragraph 35.11). The staff do not think that applying the proposed amendments to Section 2-28 and 30-35 retrospectively would be significantly burdensome for SMEs. Nevertheless the staff thinks that paragraph A1 of the ED should include an 'impracticable' exemption, like paragraph 35.11, in case there are circumstances that the staff have not considered where retrospective application would be impracticable.

92. The staff agree with the respondents that said if a proposed amendment in the ED is based on a change to full IFRS that was applied prospectively, it should be applied prospectively in the *IFRS for SMEs* as well. However, the staff do not think this is applicable to any of the proposed amendments in the ED.

Staff recommendation

93. The staff recommend revising paragraph A1 of the ED and adding new paragraphs A2-A3 as follows:

A1 Amendments to the *IFRS for SMEs*, issued in [date], amended paragraphs XXX and the glossary of terms; added paragraphs XXX; and deleted paragraphs XXX. An entity shall apply those paragraphs for annual periods beginning on or after [date]. Amendments to Sections 2–34 shall be applied retrospectively in accordance with Section 10 *Accounting Policies, Estimates and Errors* except as permitted in paragraph A2. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

A2 If it is impracticable for an entity to apply any new or revised requirements in the amendments to Sections 2-34 retrospectively, the entity shall apply those requirements in the earliest period for which it is practicable to do so. In addition an entity may elect to apply the amendments to Section 29 prospectively from the date it first applies the Amendments to the *IFRS for SMEs*, issued in [date].

A3 The entity shall disclose the amounts in the financial statements that have not been restated as a result of applying paragraph A2.

SMEIG view on staff recommendation

The majority of SMEIG members supported the staff recommendation without modification.

However, a few SMEIG members supported requiring prospective application of the amendments to the *IFRS for SMEs* for cost-benefit reasons and to ensure consistency between entities.

A few SMEIG members supported having an 'undue cost or effort' exemption in the new paragraph A2 instead of an 'impracticable' exemption for consistency with other sections of the *IFRS for SMEs*.

Question for the IASB

9) Do you agree with the staff recommendation?

Issue 10) Other specific issues on requirements in the *IFRS for SMEs*

Feedback from respondents to the ED

94. The following points summarise the additional comments made by respondents about specific requirements in the *IFRS for SMEs* (ie those not related to the proposed amendments in the ED). Each of these suggestions was made by only a few respondents:

(a) **The title of the *IFRS for SMEs*** should be changed to focus on the entities within its scope.

(b) **OCI should be removed from the *IFRS for SMEs*** because instances where items are presented in OCI are limited.

(c) **Fall-back to IFRSs for financial instruments**. Some respondents said SMEs should be permitted to use the recognition and measurement requirements of IFRS 9 when it has been completed. However other respondents said the fallback to IFRSs should be removed completely and the *IFRS for SMEs* should be a self-contained Standard. Other respondents said if the fallback to IAS 39 *Financial Instruments: Recognition and Measurement* remained, it would be important to clarify which version of IAS 39 is being referred to.

(d) **Clarify meaning of 'transaction price'** for initial recognition of financial instruments. Some SMEs have off-market interest-based arrangements with related parties, eg staff loans at less than market rates. Some respondents asserted that there is diversity in practice across countries and some SMEs are interpreting 'transaction price' as the price of the transaction rather than fair value of the financial instrument.

(e) **Guidance on fair value measurements** in Section 11 *Basic Financial Statements* should be moved into a separate section to make it more accessible and clarify that the guidance applies both to financial instruments and to non-financial items.

(f) **Hedging requirements** are more restrictive than full IFRSs following the release of the new hedging requirements in IFRS 9. Allow more situations in which hedge accounting can be used, consistent with IFRS 9. This will allow SMEs to apply hedge accounting when it reflects their risk management strategies, without onerous conditions. Some respondents said that the IASB should consider the outcome of the Exposure Draft issued by the UK FRC, FRED 51, which proposed to amend Section 12 in FRS 102 to incorporate hedging requirements based on IFRS 9[9].

(g) **Accounting for investment property** should allow a choice between the fair value model and cost model like full IFRSs. This would be easier to apply than the 'undue cost or effort' exemption, and avoid confusion for users of the financial statements of potentially having some investment property measured under the fair value model and some measured under the cost model.

(h) **Presentation of investment property** in the statement of financial position should be determined by the nature of the asset, not its measurement basis. Investment property should be presented as investment property, not PPE, regardless of whether it is measured under the cost model or the fair value model

(i) **Accounting for components of PPE** is complex. Respondents suggested either simplifying the accounting or providing further education material. Some respondents suggested allowing SMEs to derecognise component parts at their replacement cost when it is not practicable to determine the carrying amount, a simplification in paragraph 70 of IAS 16 *Property, Plant and Equipment*.

(j) **Share subscription receivables** should be presented as an asset when certain criteria are met.

(k) **Accounting for biological assets** should allow a choice to use the cost model. This is a complex area that requires use of significant judgement.

[9] The final amendment to FRS 102 from FRED 51 was issued in July 2014 and is available here: https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Amendments-to-FRS-102-The-Financial-Reporting-Stan.aspx.

Staff analysis of the feedback on the ED

95. **The title of the *IFRS for SMEs*.** The IASB has discussed the title of the *IFRS for SMEs* at length, both during development of the *IFRS for SMEs* and when considering the responses to the RfI. Paragraphs BC78–BC79 in the Basis for Conclusions accompanying the *IFRS for SMEs* explain the IASB's reasoning for using the current title. The title *IFRS for SMEs* is well established and the staff do not think that it should be reconsidered.

96. **Fall-back to IFRSs for financial instruments**. The *IFRS for SMEs* currently permits entities to choose to apply either the provisions of both Section 11 and 12 in full or the recognition and measurement provisions of IAS 39 and the disclosure requirements of Sections 11 and 12. The *IFRS for SMEs* specifically refers to IAS 39. SMEs are not permitted to apply IFRS 9. The RfI asked a question seeking feedback on how the current option to use IAS 39 should be updated once IFRS 9 has become effective and once IAS 39 has been replaced by full IFRSs. The IASB's reasoning for maintaining a fallback to IAS 39 and not permitting use of IFRS 9 is provided in paragraphs BC52-BC53 of the ED. However the IASB observed that if IAS 39 is superseded under full IFRSs, it would need to be maintained separately for use by SMEs whilst the fallback to IAS 39 remains.

97. The staff support the IASB's reasoning in in paragraphs BC52-BC53 of the ED for not removing the fallback to IAS 39 and also not permitting a fallback to IFRS 9. However IAS 39 has been replaced by IFRS 9 in a piecemeal fashion and the staff think it may have been difficult for SMEs to locate the appropriate version of IAS 39 to follow. Now that IFRS 9 has been completed, IAS 39 will no longer be amended further by the IASB. Furthermore IAS 39 will be superseded once IFRS 9 becomes effective on 1 January 2018, which will be before the effective date of the amendments from the next review of the *IFRS for SMEs*. Consequently, the staff think the latest and final full version of IAS 39 should be made easily available to SMEs on the IASB website.

98. **Clarify meaning of 'transaction price'**: The staff think that paragraph 11.13 (below) is already clear that off-market interest based arrangements contain a

financing transaction. Consequently paragraph 11.13 would require them to be measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument. The staff do not think that further clarification is necessary.

> 11.13 When a financial asset or financial liability is recognised initially, an entity shall measure it at the transaction price (including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss) unless the arrangement constitutes, in effect, a financing transaction. A financing transaction may take place in connection with the sale of goods or services, for example, if payment is deferred beyond normal business terms or is financed at a rate of interest that is not a market rate. If the arrangement constitutes a financing transaction, the entity shall measure the financial asset or financial liability at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

99. **Guidance on fair value**: The staff think that moving the fair value guidance into a separate section would be an unnecessary burden on SMEs that are currently applying the *IFRS for SMEs,* particularly in view of the fact that the guidance has not been updated for change in IFRS 13. Although the guidance relates to measurement of other assets, it is primarily applicable to financial instruments. Other sections currently make reference to the guidance in Section 11 and the staff are not aware of significant confusion in practice of the positioning of the guidance. The staff think the IASB should only consider moving the guidance into a separate section if/when it is modified to incorporate changes under IFRS 13.

100. **Presentation of investment property**: The staff agree that the presentation of investment property in the statement of financial position should be determined by the nature of the asset, not its measurement basis. Currently the staff think that most SMEs would show investment property measured at cost separately as a class of PPE (see paragraph 4.11(a)). However this disclosure would be required in the notes, not on the face of the statement of financial position. Consequently, the staff suggest that 'investment property carried at fair value through profit or loss' and 'investment property carried at cost less accumulated depreciation and impairment' should be shown separately on the face of the statement of financial position. A similar requirement is currently required for biological assets.

101. **Accounting for components of PPE**. The *IFRS for SMEs* provides a slight simplification from full IFRSs for the accounting for components of PPE. Section 17 *Property, Plant and Equipment* requires the cost to be allocated to the 'major'

components of an item of PPE, rather than the 'significant' components required by IAS 16. The staff think it is important for SMEs to account for major components of PPE separately and so does not suggest simplifying this requirement further. Some respondents asked for education material if the requirements are not simplified. Module 16 *Property, Plant and Equipment* of the IFRS Foundation training material online has two examples to illustrate accounting for components in accordance with paragraphs 17.6 and 17.16. The staff do not suggest adding further guidance in the body of Section 17. Nevertheless, the staff agree with those respondents that suggested adding the simplification in IAS 16.70 that would allow SMEs to derecognise component parts at their replacement cost when it is not practicable to determine the carrying amount.

102. **Accounting for biological assets.** The IASB discussed whether to permit a cost model for biological assets both during development of the *IFRS for SMEs* and when considering the responses to the RfI. The staff support the IASB's reasoning in paragraphs BC124 and BC146 of the Basis for Conclusions accompanying the *IFRS for SMEs* and do not think the IASB should reconsider a cost model for all biological assets. Furthermore, the staff do not think the changes under *Agriculture: Bearer Plants* (Amendments to IAS 16 and IAS 41) that permit a cost model for bearer plants, a subset of biological assets, should be considered during this comprehensive review. The *IFRS for SMEs* only requires an entity to account for a biological asset using the fair value model if its fair value is readily determinable without undue cost or effort. Plantation companies have told the IASB that fair value measurements of bearer plants are complex and costly in the absence of active markets for those assets. If this is the case, the 'undue cost or effort' exemption should be considered by SMEs. Consequently the staff do not think that there is an urgent need to incorporate the changes under *Agriculture: Bearer Plants* (Amendments to IAS 16 and IAS 41) during this comprehensive review (Note: the IASB decided not to incorporate new or revised IFRSs issued after the ED had been issued at its October 2014 meeting unless there is an urgent need for SMEs or users of SME financial statements).

103. **Other issues.** The issues in the following paragraphs were raised by respondents to the RfI and so have already been considered by the IASB. Only a small number of respondents raised these issues again and generally did not provide their reasons for doing so. Consequently, the staff do not think that there is a convincing enough argument to reconsider the IASB's previous decisions. The staff support the IASB's reasoning in the ED as follows:

(a) Paragraph 94(b) – See paragraph BC86(b) in the ED. The staff also note that the IASB decision at its October 2014 meeting to include an option for SMEs to apply a revaluation model for PPE will increase the number of items recognised in OCI in the *IFRS for SMEs*.

(b) Paragraph 94(f) – See paragraph BC86(c) in the ED

(c) Paragraph 94(g) – See paragraph BC86(d) in the ED

(d) Paragraph 94(j) – See paragraphs BC64-BC66 in the ED

Staff recommendation

104. The staff recommend that paragraph 4.2 of the *IFRS for SMEs* is amended as follows:

4.2 As a minimum, the statement of financial position shall include line items that present the following amounts:

(a) ….

(fa) <u>investment property carried at cost less accumulated depreciation and impairment.</u>

(f<u>b</u>) investment property carried at fair value through profit or loss.

(g) **…..**

105. The staff recommend that paragraph 17.6 of the *IFRS for SMEs* is amended as follows:

17.6 Parts of some items of property, plant and equipment may require replacement at regular intervals (eg the roof of a building). An entity shall add to the **carrying amount** of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the replacement part is expected to provide incremental future benefits to the entity. The carrying amount of those parts that are replaced is **derecognised** in accordance with paragraphs 17.27–17.30. <u>If it is not practicable for an entity to determine the carrying amount of the replaced part, the entity may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed</u>. Paragraph 17.16 provides that if the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and **depreciate** each such component separately over its **useful life.**

106. The staff do not recommend any other changes to the *IFRS for SMEs* (note however see paragraph 107 below).

SMEIG view on staff recommendation

Nearly all SMEIG members supported the staff recommendation above for dealing with these specific issues without modification.

The only issues raised by more than two SMEIG members were:

- Concern about the title '*IFRS for SMEs*'. These SMEIG members noted that the name of the Standard is problematic because many people think the Standard is only intended for small businesses and is, therefore, not appropriate for larger entities.

- IFRS 9 *Financial Instruments* will become effective before the next review of the *IFRS for SMEs* is completed. The ED proposes to retain the fallback to IAS 39. The IASB should consider whether this is appropriate and whether a fallback to IFRS 9 should be considered

107. <u>Additional staff recommendation not discussed with the SMEIG</u>: The staff recommend that the latest version of IAS 39 is posted to the SME webpages of the IASB website and reference is made to this location in the updated version of the *IFRS for SMEs*.

Question for the IASB
10) Do you agree with the staff recommendation?

Issue 11) Consideration of IAS 32 (2009 amendment) *Classification of Rights Issues* (additional issue raised by the staff)

108. In the ED the IASB proposed that the main change in IAS 32 *Classification of Rights Issues* (2009 amendment) should be incorporated in the *IFRS for SMEs* (Proposed Amendment 56(a) in the ED). The IASB made its selection of the new and revised IFRSs to be incorporated in the ED on the basis that they are relevant to SMEs; they provide additional clarity and in most cases a simplification, and/or they fix known or expected problems or diversity in practice. Furthermore, the

IASB noted that each of the new or revised IFRSs proposed to be incorporated in the ED would only modify one or two paragraphs in the *IFRS for SMEs*, and so the resulting changes would be minimal and be consistent with maintaining stability during the early years of implementing the *IFRS for SMEs* (see paragraphs BC35- BC36 of the ED).

Staff analysis

109. The ED proposed the following change to the definition of a financial liability (new text is underlined) based on the incorporation of IAS 32 *Classification of Rights Issues* (2009 amendment): A financial liability is:

> Any liability that is:
>
> (a) a contractual obligation:
>
> (i) to deliver cash or another financial asset to another entity; or
>
> (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, or
>
> (b) a contract that will or may be settled in the entity's own equity instruments and:
>
> (i) under which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments, or
>
> (ii) will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, <u>rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own equity instruments. Also for these purposes</u> the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

110. Respondents to the ED did not highlight this proposed change as a concern. Nevertheless, the staff have reconsidered this proposed amendment and question whether it meets the requirement of being relevant to SMEs. The staff think it adds unnecessary complexity to the definition of a financial liability for SMEs.

111. IAS 32 *Classification of Rights Issues* (2009 amendment) addresses a specific scenario. This is a scenario where rights, options and warrants are issued by an entity to its shareholders:

(a) to acquire a fixed number of an entity's own shares (or other non-derivative equity instruments) for a fixed amount;

(b) in a currency other than the entity's functional currency; and

(c) the offer is made pro-rata to all existing shareholders of the same class of the entity's own shares.

112. The staff further note that this scenario was addressed by the IASB primarily in response to concerns, arising during the global financial crisis, when publicly-traded entities were using the rights issue mechanism to raise additional capital. In particular, the rights issues were sometimes denominated in a currency other than the entity's functional currency because the entity was listed in more than one jurisdiction.

Staff recommendation

113. The staff recommend that no changes are proposed to the current definition in the *IFRS for SMEs* (ie the staff recommend not making the proposed change shown in underline in paragraph 109).

Question for the IASB
11) Do you agree with the staff recommendation?

Appendix: Amendments to FRS 102 for basic financial instruments

A1. The full amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* for basic financial instruments and hedge accounting are available at: https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Amendments-to-FRS-102-The-Financial-Reporting-Stan-File.pdf.

A2. The changes made to Section 11 *Basic Financial Statements* of FRS 102 (pages 7-10 of the amendments to FRS 102), addressed in Issue 3 of this agenda paper, are reproduced in this appendix.

Amendments to Section 11
Basic Financial Instruments

4 Paragraph 11.6(c) is amended as follows:

(c) financial instruments that qualify and are designated as ~~**hedging instruments**~~hedging instruments in accordance with the requirements in Section 12; and

5 Paragraph 11.8(b) is amended as follows:

(b) a debt instrument (such as an account, note, or loan receivable or payable) that meets the conditions in paragraph 11.9 and is not a financial instrument described in paragraph 11.6(b);

6 Paragraph 11.9 is amended as follows:

11.9 ~~A debt instrument that satisfies all of t~~ The conditions a debt instrument shall satisfy in accordance with paragraph 11.8(b) are~~(a) to (d) below shall be accounted for in accordance with Section 11~~:

(a) The contractual ~~R~~returns to the holder (the lender), assessed in the currency in which the debt instrument is denominated, ~~are~~ is:

(i) a fixed amount;

(ii) a positive fixed rate or a positive variable rate[11]~~over the life of the instrument~~; or

(iii) ~~variable return that, throughout the life of the instrument, is equal to a single referenced quoted or observable interest rate (such as LIBOR) or~~ [not used]

(iv) ~~some~~ a combination of ~~such~~ a positive or a negative fixed rate and a positive variable rate~~s~~ (eg ~~such as~~ LIBOR plus 200 basis points or LIBOR less 50 basis points, but not 500 basis points less LIBOR).~~, provided that both the fixed and variable rates are positive (eg an interest rate swap with a positive fixed rate and negative variable rate would not meet this criterion). For fixed and variable rate interest returns, interest is calculated by multiplying the rate for the applicable period by the principal amount outstanding during the period.~~

(aA) The contract may provide for repayments of the principal or the return to the holder (but not both) to be linked to a single relevant observable index of general price inflation of the currency in which the debt instrument is denominated, provided such links are not leveraged.

(aB) The contract may provide for a determinable variation of the return to the holder during the life of the instrument, provided that:

(i) the new rate satisfies condition (a) and the variation is not contingent on future events other than:

(1) a change of a contractual variable rate;

(2) to protect the holder against credit deterioration of the issuer;

(3) changes in levies applied by a central bank or arising from changes in relevant taxation or law; or

(ii) the new rate is a market rate of interest and satisfies condition (a).

Contractual terms that give the lender the unilateral option to change the terms of the contract are not determinable for this purpose.

(b) There is no contractual provision that could, by its terms, result in the holder losing the principal amount or any interest attributable to the current period or prior periods. The fact that a debt instrument is subordinated to other debt instruments is not an example of such a contractual provision.

(c) Contractual provisions that permit the issuer (the borrower) to prepay a debt instrument or permit the holder (the lender) to put it back to the issuer before maturity are not contingent on future events other than to protect:

(i) the holder against the credit deterioration of the issuer (eg defaults, credit downgrades or loan covenant violations), or a change in control of the issuer; or

(ii) the holder or issuer against changes in levies applied by a central bank or arising from changes in relevant taxation or law.

The inclusion of contractual terms that, as a result of the early termination, require the issuer to compensate the holder for the early termination does not, in itself, constitute a breach of this condition.

(d) ~~There are no conditional returns or repayment provisions except for the variable rate return described in (a) and prepayment provisions described in (c).~~[not used]

(e) Contractual provisions may permit the extension of the term of the debt instrument, provided that the return to the holder and any other contractual provisions applicable during the extended term satisfy the conditions of paragraphs (a) to (c).

7 A footnote is inserted as indicated in paragraph 11.9(a)(ii) as follows:

[Footnote 11]

11 A variable rate for this purpose is a rate which varies over time and is linked to a single observable interest rate or to a single relevant observable index of general price inflation of the currency in which the instrument is denominated, provided such links are not leveraged.

8 The following examples are inserted below paragraph 11.9:

Examples – Debt instruments

1 **A zero-coupon loan**

For a zero-coupon loan, the holder's return is the difference between the nominal value of the loan and the issue price. The holder (lender) receives a fixed amount when the loan matures and the issuer (borrower) repays the loan. The return to the holder meets the condition of paragraph 11.9(a)(i).

2 **A fixed interest rate loan with an initial tie-in period which reverts to the bank's standard variable interest rate after the tie-in period**

The initial fixed rate is a return permitted by paragraph 11.9(a)(ii). A bank's standard variable interest rate is an observable interest rate and, in accordance with the definition of a variable rate, is a permissible link. In accordance with paragraph 11.9(a)(ii) the variable rate should be a positive rate.

The variation of the interest rate after the tie-in period is non-contingent and since the new rate (ie the bank's standard variable rate) meets the condition of paragraph 11.9(a), paragraph 11.9(aB)(i) is met.

3 **A loan with interest payable at the bank's standard variable rate plus 1 per cent throughout the life of the loan**

As discussed under Example 2 above, a bank's standard variable rate is a permitted variable rate in accordance with the definition of variable rate. The combination of a positive fixed rate (ie plus 1 per cent) and a positive variable rate is a permitted return under paragraph 11.9(a)(iv). The combination of a bank's standard variable rate plus a fixed interest rate of 1 per cent therefore meets the condition in paragraph 11.9(a)(iv).

4 **A loan with interest payable at the bank's standard variable rate less 1 per cent throughout the life of the loan, with the condition that the interest rate can never fall below 2 per cent**

Paragraph 11.9(aB)(i)(a) permits variation of a return to a holder (lender) that is contingent on a change of a contractual variable rate. In this example the contractual variable rate is the bank's standard variable rate. The variation of the return to the holder is between the bank's standard variable rate less 1 and 2 per cent, depending on the bank's standard variable rate. For example, if the bank's standard variable rate is less than 3 per cent, the return to the holder is fixed at 2 per cent; if the bank's standard variable rate is higher than 3 per cent, the return to the holder is the bank's standard variable rate less 1 per cent. The contractual variation meets the condition of paragraph 11.9(aB)(i)(1).

The holder is protected against the risk of losing the principal amount of the loan via the interest rate floor of 2 per cent. The requirement of paragraph 11.9(b) is therefore also met.

5 **Interest on a loan is referenced to 2 times the bank's standard variable rate**

In accordance with the definition of a variable rate, the contractual interest rate payable can be linked to a single observable interest rate. A bank's standard variable rate is an observable rate and meets the definition of a variable rate, but the rate in this example is 2 times the bank's standard variable rate and the link to the observable interest rate is leveraged. Therefore, the rate in this example is not a variable rate as described in paragraph 11.9(a). The instrument is measured at fair value in accordance with Section 12.

6 **Interest on a loan is charged at 10 per cent less 6-month LIBOR over the life of the loan**

The effect of combining a negative variable rate with a positive fixed rate is that the interest on the loan increases as and when the variable rate decreases and vice versa (so called inverse floating interest).

Under paragraph 11.9(a)(iv) the combination of positive or negative fixed rate and positive variable rate is a permitted return. The variable rate (6-month LIBOR) meets the definition of a variable rate, as the rate is a quoted interest rate. However, since the variable rate is negative (minus 6-month LIBOR), the rate is in breach of paragraph 11.9(a)(iv). The instrument is measured at fair value in accordance with Section 12.

7 **Interest on a GBP denominated mortgage is linked to the UK Land Registry House Price Index (HPI) plus 3 per cent.**

In accordance with paragraph 11.9(aA) the holder's return may be linked to an index of general price inflation of the currency of the debt instrument. The mortgage is denominated in GBP and a permitted inflation index would be an index that measures general price inflation of goods and services denominated in GBP.

The HPI measures inflation for residential properties in the UK and is not a measure of general price inflation. The return to the holder therefore fails to meet the condition in paragraph 11.9(aA). The instrument is measured at fair value in accordance with Section 12.

9 Paragraphs 11.11(a), 11.11(b) and 11.11(c) are amended as follows:

(a) an investment in another entity's equity instruments other than non-convertible preference shares and non-puttable ordinary and preference shares (see paragraph 11.8(d)); and

(b) ~~an interest rate swap that returns a **cash flow** that is positive or negative, or a forward commitment to purchase a commodity or financial instrument that is capable of being cash-settled and that, on settlement, could have positive or negative cash flow, because such swaps and forwards do not meet the condition in paragraph 11.9(a);~~ [not used]

(c) ~~options and forward contracts, because returns to the holder are not fixed and the condition in paragraph 11.9(a) is not met; and~~ [not used]

10 Paragraph 11.14(b) is amended as follows:

(b) Debt instruments that meet the conditions in paragraph 11.8(b) and commitments to receive a loan and to make a loan to another entity that meet the conditions in paragraph 11.8(c) may upon their initial recognition be designated by the entity as at fair value through profit or loss (paragraphs 11.27 to 11.32 provide guidance on fair value) provided doing so results in more relevant information, because either: