IFRS for SMEs under review

by Wayne Bartlett

The IFRS for SMEs Standard is an important compromise for those who wish to report using IFRS-compliant approaches but do not want, or do not have the resources, to prepare a comprehensive set of financial statements that ticks all the boxes of the potentially time-consuming and complex IFRS framework in its full form. It's important to remember that financial reporting is not a free good. It takes time, effort and money to collect all the information that fully comprehensive IFRS reporting requires.

It's also useful to remind ourselves of a couple of basic principles which are enshrined in the IFRS Conceptual Framework, namely materiality and cost-benefit. They are principles I find myself drawn back to on an ever-increasing basis. IFRS financial statements should focus on the items that really matter to the users of financial statements: shareholders, lenders, creditors and the like.

There is also an acceptance in the IFRS framework that preparers of financial statements are entitled to consider the cost of collecting and reporting information for the financial statements against the benefits that users obtain from reviewing it. If the costs exceed the benefits, then preparers do not need to assemble the information that would theoretically be required in other circumstances.

These two principles underpin the IFRS for SMEs Standard. As the name implies the Standard is targeted at smaller businesses and those which are not public interest entities, i.e. who are not quoted on a public market. The Standard provides a slimmed-down version of 'full' IFRSs.

It substantially reduces disclosure requirements and makes the associated accounting less complex. At the same time there is a trade-off. Preparers have less choice under IFRS for SMEs and consequently less flexibility, a situation that not everyone will welcome.

The Structure of the IFRS for SMEs Standard

Broadly paraphrased, the Standard adopts five different types of simplification when compared to full IFRS. These are:

- Some topics that are included in full IFRS Standards are omitted because they are not relevant to typical SMEs.
- Some of the policy options that are included in full IFRS Standards are not included because of the simplified reporting requirements included in the IFRS for SMEs Standard.
- Many recognition and measurement principles included in full IFRS are simplified.
- There are substantially fewer disclosures required.
- The language in the IFRS for SMEs Standard is also simplified with a deliberate focus on 'plain English'.

The Standard is divided into 35 sections which largely link to equivalent full IFRS Standards. For example, there are sections on specific financial statements (sections 4-7 on individual financial statements such as the statement of financial position or the cash flow statement), on revenue (section 23) or on property, plant and equipment (section 17). The linkage includes some of the more obscure IFRS Standards such as the rarely used guidance concerning hyperinflation. So, in principle every situation that might be encountered with respect to the full IFRS framework is also covered within the IFRS for SMEs Standard, albeit in a simplified and more manageable form.

However, the full IFRS framework is constantly evolving. New Standards emerge and existing ones are modified based on experience or unforeseen events and there is a need to ensure that the IFRS for SMEs Standard stays synchronised in line with these changes to the 'full' Standards. There is also the possibility that issues relating specifically to the implementation of the SME Standard may arise that need clarification and potentially emendation of it. Therefore, there is an inbuilt regular review process for the SMEs Standard to ensure that it stays current in line with developments to the 'full' Standards on which it is based.

Issues concerning the maintenance of the IFRS for SMEs Standard are covered in the Preface to the Standard itself. Potential changes to it will be discussed in what the Standard-setters call an 'omnibus' Exposure Draft. This will not be issued more than once every three years though there is provision within the Preface for emergency Standard updates to be made on what are foreseen to be very rare occasions.

Once the Standard has been updated and re-published then implementers will have a year to deal with any changes that impact on their own accounting and reporting.

The latest update

The first IFRS for SMEs standard was issued in 2009. This was amended for the first time in 2015 with any changes becoming effective from 1 January 2017. Work towards the second change to the Standard began back in 2018.

This is now nearing the end of the process. Work is in hand to circulate an exposure draft to discuss potential changes with interested parties. The aim is that the International Accounting Standards Board (IASB) will be in a position to issue this exposure draft by the end of 2022.

However, a sneak preview of some of the issues under discussion can be gleaned from the spring meeting of the International Forum of Accounting Standard Setters (IFASS) which was held in March 2022. During these discussions the IASB gave feedback on the current status of the update project and the kind of issues that are emerging.

These conversations reveal first of all some philosophical issues that are underpinning the IASB's thinking. The kind of questions that are being asked with respect to any possible changes are:

- Would any change make a difference to the decisions of users ('relevance')?
- Is it possible to make appropriate simplifications ('simplification')?
- Does the outcome faithfully represent the bona fide economic situation ('fair presentation')?
- Last but not least, are any changes potentially going to lead to benefits that outweigh the costs ('cost-benefit')?

After considering these high-level issues, there are some detailed potential changes that appear to be on the cards though the precise level of detail will become more apparent when the exposure draft is issued. The IASB has been considering the alignment of full IFRS Standards with the IFRS for SMEs Standard in specific cases, leading on an individual Standard basis to three potential scenarios:

- A scenario where there should be **alignment** between the full IFRS Standard and the IFRS for SMEs Standard.
- A scenario where there should be **partial alignment** between the full IFRS Standard and the IFRS for SMEs Standard.

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- A scenario where there should be **no alignment** between the full IFRS Standard and the IFRS for SMEs Standard.

IFRS Standards that should be aligned

In the first category of those which should be aligned there are four specific items to consider. In such cases, there will need to be a rewrite as a new section in the IFRS for SMEs Standard. This does not mean that everything in the SMEs Standard will involve new requirements that have never been dealt with before.

As an example, there would need to be a new section on fair value measurements, but these would not be brand new requirements. Rather what is required is a re-writing of existing requirements in the current version of the SMEs Standard into a new section.

The four items in question are:

- The Conceptual Framework for Financial Reporting
- IFRS 3 – Business Combinations
- IFRS 13 – Fair Value Measurement
- IFRS 15 – Revenue from Contracts with Customers

Partial alignment with IFRSs

In areas of partial alignment rather than writing a new section, what is required is an update to current sections in the IFRS for SMEs Standards. Here, there are three specific IFRS Standards to consider which are:

- IFRS 10 – Consolidated Financial Statements
- IFRS 11 – Joint Arrangements
- IFRS 9 – Expected Credit Loss

IFRS 9 is an interesting one. It introduces new more stringent requirements on Expected Credit Losses which have already led to a bit of consternation during the pandemic and its associated fall-out. In the amendments which are under consideration in the SMEs Standard there will be a dual model looking at incurred and expected credit losses.

No alignment with IFRSs

There are some full IFRS Standards where it is felt that no changes to the SMEs Standard are required. These are:

- IFRS 14 – Regulatory Deferral Accounts
- IFRS 16 – Leases
- IAS 19 – Employee Benefits

IFRS 14 is perhaps understandable as it relates to a rather specific state of affairs that is likely to have very limited application amongst SMEs. However, the situation on leases seems to have proved somewhat controversial. There does not seem to be unanimity on whether or not this important and potentially highly significant relatively new Standard should be rolled out to include the SMEs Standard. Perhaps this is something which will be discussed further during the exposure draft discussions and maybe the final version of the Standard update which ultimately emerges may take this into account. After all, one of the objectives of the whole process is to have a detailed conversation about what should be changed and what should not.

In conclusion

So, in summary the discussion is ongoing. By the end of this year, we should be much clearer about the changes. Perhaps most interesting of all is the impact that the emergence of changes to the full IFRS regime have on the IFRS for SMEs Standard. This is all part of an ongoing debate about materiality and cost versus benefits. At the end of the day there is a balance to be struck about permitting less detailed approaches for smaller entities but at the same time ensuring that the financial statements which they produce give enough information to potential users to be useful and assist them in their decision-making. The entities involved may in relative terms be small, but they are not as far as their stakeholders are concerned irrelevant.

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