Financial Reporting Council

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21 October 2020

Dear Board Members

Request for Information: Comprehensive Review of the *IFRS for SMEs* Standard

I am writing on behalf of the UK's Financial Reporting Council (FRC) in response to the IASB's Request for Information – Comprehensive Review of the *IFRS for SMEs* Standard.

Our response draws on the FRC's experience of developing UK and Ireland accounting standards for entities not applying EU-adopted IFRS. This includes FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, the requirements of which are based on the *IFRS for SMEs* Standard. Our response also draws on outreach with stakeholders, including feedback received as part of our review of FRS 102 in 2017 which sought views on aligning FRS 102 with major changes in IFRS. The views expressed in this response are separate from and will not necessarily affect the FRC's future development and maintenance of UK and Ireland accounting standards.

We agree that aligning the *IFRS for SMEs* Standard with full IFRS Standards over the longer-term is desirable. Using IFRS Standards as a starting point allows the extensive knowledge from the development and application of these standards to be reflected in the development of the *IFRS for SMEs* Standard. Therefore, we believe it is important that the Board's framework is both flexible and allows enough time for this knowledge to be captured and filtered through into the standard setting process.

An important aspect of this approach relates to the implementation experience of those preparing accounts under full IFRS Standards. Their experiences may enable the identification of key aspects of the new IFRS Standards that will have to be simplified to remain proportionate and cost-effective for entities applying the *IFRS for SMEs* Standard.

The FRC is pleased to note that the IASB has developed a set of principles to determining whether or not to amend the *IFRS for SMEs* Standard in response to changes in IFRS Standards, as suggested in our response to the initial comprehensive review of the Standard. We support the proposed principles but believe that they could be clearer.

In particular, we believe that the balance between the costs to SMEs of providing financial information and the benefits that it provides to users should continue to feature prominently the development of the *IFRS for SMEs* Standard. We recommend that the cost-benefit consideration is reflected either as a separate principle or acknowledged explicitly within the principle of simplicity.

We also believe that placing greater emphasis on this concept at the standard-setting stage would reduce the need for preparers to make 'cost benefit' judgements when applying the *IFRS for SMEs* Standard. This is evident in the current 'undue cost or effort' exemptions included in the Standard. Applying these exemptions requires a considerable level of judgement and information. Therefore, we do not believe these exemptions should be applied by SMEs and should not be retained. Alternatives could be developed in those instances where the exemption is currently available, such as simpler accounting policies, accounting policy choices, or establishing clear boundaries for the use of simpler alternatives.

Our responses to the questions in the Request for Information are included the Appendices to this letter.

If you have any queries, or would like to discuss our comments in more detail, please do not hesitate to contact Jenny Carter (Acting Director of Accounting & Reporting Policy, 020 7492 2421, j.carter@frc.org.uk) or Easton Bilsborough (Project Manager, 020 3145 9228, e.bilsborough@frc.org.uk).

Yours sincerely,

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Appendix A: Part A – Strategic and general questions

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

A1 We believe the *IFRS for SMEs* Standard should be aligned with full IFRS Standards, on a proportionate basis. We note, however, as is reflected by Question G1B and our response to it, that 'alignment' is not a precise concept.

A2 The current objective in the *IFRS for SMEs* Standard focuses on the broad range of users of the financial statements of SMEs, and we believe that the IASB should retain that approach. However, although the existing and potential users of financial statements prepared under both standards may fit into the same stakeholder groups, their needs may differ. Therefore, it is reasonable that an alternative to alignment with full IFRS Standards may better meet the overriding objective of the *IFRS for SMEs* Standard in some circumstances. Therefore, departures from the requirements of full IFRS Standards may be justified.

A3 This requires consideration of the information needs of users of SMEs financial statements, and the IASB's ability to assess these. We observe that the needs of users of financial statements standards based on the *IFRS for SMEs* Standard may differ in different jurisdictions. The IASB should incorporate an overall assessment of the needs of users into the development of the standard, but there may remain a need for it to be tailored to the particular information needs of users at a local level.

A4 The interaction between alignment with full IFRS Standards and the objective of the financial statements of private entities is reflected in the FRC's current principles for developing financial reporting standards for the UK and the Republic of Ireland. Financial reporting standards for the UK and Ireland are aligned with full IFRS Standards except in those instances when an alternative approach better meets the overriding objective. This principle acknowledges it may be necessary to take a 'non-IFRS-based' approach to meet the FRC's objective in developing financial reporting standards. Similarly, there may remain instances when the *IFRS for SMEs* Standard adopts a different approach to full IFRS Standards. For example, the *IFRS for SMEs* Standard requires goodwill to be amortised due to the expertise and costs involved in testing it annually for impairment.

A5 We agree with the reasons for alignment listed in paragraph 30 of the Request for Information. Within the UK, a key benefit of all entities applying an IFRS-based framework has been the ability to benchmark and compare entities of different sizes. An important consideration is that alignment also makes it easier for entities to migrate to full IFRS Standards as they grow.

Question G1B — Alignment approach
What extent of alignment of the *IFRS for SMEs* Standard with full IFRS Standards do you consider most useful, and why? **(a) alignment of principles;** **(b) alignment of both principles and important definitions; or** **(c) align of principles, important definitions and the precise wording of requirements?** **Please explain the reasoning that supports your choice of (a), (b) or (c).**

A6 We consider the alignment of both principles and important definitions of full IFRS Standard to be the most useful approach.

A7 Applying common principles but simplifying the language and the wording of the requirements of full IFRS Standards when relevant, allows the *IFRS for SMEs* Standard to be proportionate for those entities within its scope. Although the precise wording of the requirements of full IFRS Standards are not replicated, a similar outcome should be achieved in the majority of cases.

A8 This approach requires accepting that alignment may, in some cases, lead to slightly different outcomes when compared to full IFRS Standards. Preparers may take a different view as they apply differently worded requirements. Therefore, there may be instances when this approach impacts on the quality of reporting, which can be weighed up as part of the cost-benefit considerations.

A9 This approach also acknowledges the usability of the *IFRS for SMEs* Standard; a shorter standard using more straightforward language.

A10 Furthermore, the approaches described in this question exist on a spectrum. Although we generally consider alignment of both principles and important definitions to be the most useful approach, a different approach may sometimes be necessary depending on the issue being addressed. This will depend on whether an entity may reach a different accounting outcome and the impact that this would have on the users of their financial statements.

A11 For example, we believe that aligning important definitions is not the most useful approach when considering the definition of control in Section 9 *Consolidated and Separate Financial Statements* and IFRS 10 *Consolidated Financial Statements*. As discussed in our response to Question S2A, we consider that there would be relatively few instances when entities applying the definition of control in the *IFRS for SMEs* Standard would reach a different accounting outcome. Therefore, the impact of alignment for users of financial statements would be minimal.

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

A12 We believe these principles will assist in the development of the *IFRS for SMEs* Standard. Applied correctly, they will provide a framework to support consistent decisions being made about how the *IFRS for SMEs* Standard should be aligned with full IFRS Standards. Establishing a framework can also improve stakeholders' understanding of the standard and how it is developed. This may contribute towards greater engagement and more consistent application of the standard over the long-term.

A13 Many of these benefits have been experienced by the FRC in taking a principles-based approach to the development of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. New or amended IFRS Standards are considered against five principles to determine whether FRS 102 should be updated.

A14 We understand that the alignment principles are intended to be applied as package of three 'tests' which are considered consecutively. We think this proposed process is logical. However, this is not captured in the description of the principles in Part A of the Request for Information. We recommend the drafting is revisited so that the intended application of the principles is clear.

A15 Comments on each principle are provided below.

Relevance to SMEs

A16 Paragraph 33 of the Request for Information describes relevance from two perspectives:

(a) Relevance of information to the decisions of financial statements users; and

(b) Relevance of problems to SMEs.

A17 Relevance is considered from the perspective of financial statement users in the 2018 Conceptual Framework. Although we believe the relevance of a problem to the entities applying the *IFRS for SMEs* Standard should influence its scope, expanding the principle to incorporate this perspective confuses what is a well-accepted qualitative characteristic of useful financial reporting. Doing so also risks the principle being interpreted differently and applied inconsistently.

A18 We recommend that the principle clearly distinguishes both perspectives. This could be done by describing the principle as '*relevance to the transactions SMEs undertake, and relevance to the users of their financial statements'*.

A19 The reference to the relevance of the 'transactions SMEs undertake' implies that the *IFRS for SMEs* Standard will not address every transaction, other event, or condition that an entity may need to account for. However, it should seek to cover those most prevalent to entities applying the Standard. We believe this approach is necessary to avoid the scope of the Standard being as extensive as full IFRS. Standards This is also provided for in paragraph 10.6 of the *IFRS for SMEs* Standard, which allows entities to 'look up' to full IFRS in such instances.

A20 Paragraph 33 of the Request for Information also describes relevance by reference to the 'problem' addressed by an IFRS Standard, an amendment to an IFRS Standard or an IFRIC Interpretation.

A21 The development of IFRS Standards, and subsequent amendments and interpretations, originate from projects with defined objectives which are generally framed in the positive. Therefore, applying this principle requires these objectives to be reframed as problems. This is not in keeping with the IASB's general approach to standard-setting. It also requires an assessment of whether a problem is 'bad enough' to deal with in the context of SMEs. We do not believe this starting point is appropriate for determining whether alignment should take place.

A22 We recommend the description of this principle is reframed to focus on the objectives of the IFRS Standard, and subsequent amendments and interpretations, and their relevance to the transactions SMEs undertake.

Simplicity

A23 Paragraphs 34 and 35 of the Request for Information provide no definition of simplicity. It is not clear whether simplicity is being considered from the perspective of the preparer, user or both.

A24 We consider this to be an important distinction; a standard that is 'simple' for preparers to apply will not always result in 'simple' information for financial statements users. As considering simplicity from both perspectives involves focusing on two different documents (i.e. the *IFRS for SMEs* Standard itself, and the financial statements), it should be explicit which version of simplicity is sought. Therefore, we recommend the principle be supported by a clear definition.

A25 Based on how the principle has been applied in Part B and Part C of the Request for Information, the Board has generally considered simplicity from the perspective of preparers and their application of the standard. Contained within the Board's assessment has often been an implicit 'cost-benefit' consideration.

A26 We agree the 'cost-benefit' trade-off is relevant and note that this principle has informed the development of the *IFRS for SMEs* Standard since its inception. To ensure it is applied consistently, we recommend it is either introduced as a separate principle or acknowledged explicitly within simplicity. This could be done by describing the principle as '*simplicity for preparers, reflecting cost-benefit considerations'.*

A27 We note the original intention for maintaining the *IFRS for SMEs* Standard was to make modifications to the principles of full IFRS Standards that were '*appropriate in the light of users' needs and cost-benefits considerations*'[1]. Our suggested changes would align the principles of relevance and simplicity more closely with this intention.

Faithful representation

A28 Paragraph 36 of the Request for Information describes faithful representation as a criterion that financial statements must meet. This is different to the 2018 Conceptual

[1] Paragraph BC185, *IFRS for SMEs*: Basis for Conclusions, 2015

Framework, where faithful representation is a fundamental qualitative characteristic of useful financial information. Paragraph 2.22 of the Conceptual Framework recognises the trade-off between the different fundamental qualitative characteristics of relevance and faithful representation. Doing so acknowledges that the information in useful financial statements provides a sufficiently faithful representation of economic phenomena, rather than that this characteristic must be met.

A29 The words and numbers that provide a faithful representation of economic phenomena can also be considered the same, irrespective of an entity's size and whether it has public accountability or not. Requiring financial statements prepared applying the *IFRS for SMEs* Standard to be 'representationally faithful' to the same extent as those prepared applying full IFRS Standards is not possible given that the 'limits' of the other principles will mean that the representation in each financial statements will be different.

A30 We understand that this principle is intended to act as a 'safety net' to ensure the principles of relevance and simplicity are correctly applied. However, its current description does not reflect how faithful representation is explained in the Conceptual Framework. As a result, it risks setting too high a hurdle when considering new or amended IFRS Standards for alignment.

A31 To achieve the Board's original intention, we recommend the interaction between principles is acknowledged. This could be done within the discussion of the principles themselves, or by describing the principle as '*provides a sufficiently faithfully representation*'.

Question G3 — When to consider alignment
Three possible dates for when to consider alignment are discussed in paragraphs 38–40 of part A of the Request for Information. Which, if any, of these possible dates do you prefer? **Those IFRS Standards, amendments to IFRS Standards or IFRIC Interpretations:** **(a) issued up to the publication date of the Request for Information;** **(b) effective before the publication date of the Request for Information;** **(c) effective and on which the post-implementation review was completed before the publication date of the Request for Information; or** **(d) issued or effective on some other date (please specify).** **Please explain the reasoning that supports your views, for example, the benefits of the date selected.**

A32 One of the key benefits of the *IFRSs for SMEs* Standard being based on full IFRS Standards is the ability to use the knowledge gained from developing those standards, as well the experience of those applying them. To realise this benefit, time must also be allowed for the implementation experience of preparers and users to become available.

A33 We recommend alignment should usually be considered for those amended IFRS Standards and IFRC Interpretations that are effective, when at least one-year of implementation experience is available. For substantial changes (i.e. a new IFRS Standard or a significant revision to an existing IFRS Standard), at least two years implementation experience should be available.

A34 These dates acknowledge that preparers will often encounter issues which are specific to the first year of implementation when applying a standard for the first time. Matters that present issues in this first year may not be encountered in later years once processes and policies are applied for a second time. Therefore, we believe it would be more effective to wait for a second year of implementation experience before considering more substantial changes.

A35 Findings from post-implementation reviews (PIRs) are relevant to the assessment of IFRS Standards. However, the timetable for the completion of PIRs risks delaying the development of the *IFRS for SMEs* Standard. Whilst the assessment of IFRS Standards should be supported by relevant information, it must also be timely. Delaying the assessment until the completion of the first stage of a PIR risks the Standard no longer representing up-to-date thinking about what is the 'right way' to account and delays benefits to the users of financial statements. This creates an unintentional gap between the accounting practices applied by SMEs and IFRS reporters. Therefore, we do not believe the completion of a PIR should be a prerequisite that determines the scope of the review.

A36 We recognise the certainty and stability provided by a policy which determines when to consider new or amended IFRS Standards for alignment. However, care should be taken to avoid taking an overly rigid approach that prevents developments in full IFRS Standards being considered for earlier alignment when doing so would better support the overall objective of the standard. For example, the nature of an amendment may make it particularly time sensitive and justify it being incorporated into the *IFRS for SMEs* Standard before it is effective, and usually this would be outside the typical Comprehensive Review cycle. Similarly, it may make sense to incorporate those developments that make IFRS Standards easier to apply more quickly, saving costs for preparers. Therefore, a level of flexibility is needed to ensure the approach is responsive and robust.

Appendix B: Part B – Questions on aligning specific sections of the *IFRS for SMEs* Standard

Question S1 — Aligning Section 2 *Concepts and Pervasive Principles* of the *IFRS for SMEs* Standard with the 2018 *Conceptual Framework for Financial Reporting*
What are your views on: **(a) aligning Section 2 with the 2018 *Conceptual Framework*?** **(b) making appropriate amendments to other sections of the *IFRS for SMEs* Standard?** **(c) retaining the concept of 'undue cost or effort'?**

Aligning Section 2 with the 2018 Conceptual Framework

B1 The 2018 Conceptual Framework does not exclude SMEs from its scope and can be read as applicable to financial statements prepared by entities of different sizes. It follows that it should apply to financial statements prepared by entities applying the *IFRS for SMEs* Standard. Therefore, we recommend Section 2 *Concepts and Pervasive Principles* is aligned with the Conceptual Framework.

B2 In addition, the 2018 Conceptual Framework is now being used by the IASB to develop IFRS Standards and by preparers to develop accounting policies when no standards apply. As the Framework is applied, the concepts and principles within it will become better understood and generally accepted. If the *IFRS for SMEs* Standard is not aligned with the Framework, it risks moving further away from the thinking used to develop IFRS Standards. To avoid creating an unintentional gap between the accounting practices of SMEs and IFRS reporters, the concepts and pervasive principles in both the *IFRS for SMEs* Standard and full IFRS Standards should be consistent.

Making appropriate amendments to other sections of the IFRS for SMEs Standard

B3 Logic would dictate amendments to other sections of the *IFRS for SMEs* Standard are necessary. However, doing so would mean these sections will be amended in isolation. Therefore, we recommend an explanation of those amendments made as a consequence of aligning Section 2 with the 2018 Conceptual Framework is provided that explains the changes and their potential impact. These amendments are likely to appear subtle on paper but may have significant consequences for preparers.

B4 Following its issue, the IASB decided not to amend several existing IFRS Standards for the new definitions in the 2018 Conceptual Framework. We recommend that the equivalent sections of the *IFRS for SMEs* Standard are aligned with the 2018 Conceptual Framework only if the relevant IFRS Standard has also been. This approach avoids the *IFRS for SMEs* Standard 'leaping ahead' of the development of full IFRS. This would not be in keeping with the methodology of updating the Standard and risks unintended consequences.

B5 For example, this would mean retaining the existing definition of 'asset' in Section 17 *Property, Plant and Equipment* of the *IFRS for SMEs* Standard. This definition was updated as a part of the 2018 Conceptual Framework. However, IAS 16 *Property, Plant and Equipment* has yet to be amended for this update. The recognition criterion in paragraph 7 of IAS 16 corresponds to the previous definition of an asset in the 1989

Framework. Therefore, to ensure the *IFRS for SMEs* Standard remains aligned with IAS 16, we do not believe Section 17 should be amended.

B6 In such instances, the specific requirements of Section 17 will take precedence over the definition in Section 2 (i.e. the specific requirements override the general concepts and principles). This is inferred by the hierarchy that an entity must follow in deciding on the appropriate accounting policy, as set out in paragraph 2.35 of Section 2. If Section 2 is aligned with the 2018 Conceptual Framework, there may be further instances of these inconsistencies arising. Therefore, we recommend that the application of the hierarchy is made more explicit within Section 2. One way of doing so would be for it to be explained within the scope of the Section. This approach was taken in FRS 102, where paragraph 2.1A was inserted to explain the required approach when there are inconsistencies between the concepts and principles, and the specific requirements of the standard.

Retaining the concept of 'undue cost or effort'

B7 Applying the 'undue cost or effort' exemption requires the management of an entity to make a judgement based on the costs and benefits of applying a requirement. This involves considering how the economic decisions of those that are expected to use that financial information could be affected by not having that information. The information and exercise of judgement required to apply this exemption are considerable and potentially complex. This risks the exemption being applied inconsistently in similar circumstances, and different costs being incurred in preparing financial statements. For these reasons, we do not recommend that the concept is retained.

B8 The concept of 'undue cost or effort' was included in FRS 102 when the standard was first issued. Stakeholder feedback about the application of the standard indicated that not all entities were applying sufficient rigour in assessing the availability of undue cost or effort exemptions. This resulted in entities potentially treating the exemption as an accounting policy choice. To address this issue, we removed those references to 'undue cost or effort' from FRS 102. In their place, we introduced either:

(a) simpler accounting requirements; or

(b) accounting policy choices.

B9 This removed the requirement for entities to make a judgement based on cost-benefit considerations. Instead, this assessment is now made as part of the standard setting process.

B10 As part of this process, we have encountered instances where the costs and benefits of applying an alternative accounting treatment depends on the circumstances in which it is applied. By introducing an accounting police choice, those situations where this alternative accounting treatment is permitted can be specified. This has the effect of 'ringfencing' the alternative accounting treatment to specific situations where it is considered that the cost benefit test is met.

B11 For example, the undue cost or effort exemption for the measurement of investment property was removed from FRS 102. This is based on our understanding that in the UK, entities should generally be able to obtain a fair value for an investment property without undue cost or effort, which provides useful, decision-relevant information to users of the financial statements. However, as part of the process of removing this exemption, we received stakeholder feedback which suggested that the cost of obtaining a fair value for an investment property that is rented to another group entity outweighs the benefit when the investment property is treated as property, plant and equipment in the group's consolidated financial statements.

B12 To address this situation, an accounting policy choice was introduced for entities that rent investment property to another group entity, whereby they can choose to measure that investment property either at cost or at fair value. This alternative accounting treatment is only deemed to be acceptable in this circumstance, where we consider the cost benefit test is met in a UK context. However, in a jurisdiction where the fair value of investment property is not readily determinable, the cost-benefit consideration may be different, and the alternative accounting treatment may be 'ringfenced' differently.

B13 Our responses to Question B5 and Question N5 describe other examples where we have removed references to 'undue cost or effort' in FRS 102.

Question S2A — Aligning Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Standard with IFRS 10 *Consolidated Financial Statements*
What are your views on: **(a) aligning the definition of control in Section 9 with IFRS 10; and** **(b) retaining and updating paragraph 9.5 of the *IFRS for SMEs* Standard?**

Aligning the definition of control in Section 9 with IFRS 10

B14 We do not recommend aligning the definition of control in Section 9 *Consolidated and Separate Financial Statements* with IFRS 10 *Consolidated Financial Statements*. We consider that the existing definition of control provides a boundary for financial reporting that is generally understood within the context of the entities eligible to apply the *IFRS for SMEs* Standard.

B15 The definition of control introduced by IFRS 10 was generally considered to impact financial institutions that have complex structures and interests in unconsolidated structured entities (such as special purpose entities). Therefore, the issues it addresses are less relevant to SMEs.

B16 As an alternative to amending the definition of control, a disclosure requirement could be introduced which aims to highlight any interests an entity holds in unconsolidated structured entities. This would improve the information available to users about these entities, achieving a similar outcome to IFRS 10.

B17 We introduced such a disclosure into FRS 102 as a consequence of considering whether to incorporate the control model of IFRS 10 into the standard. Paragraph 9.23(a) of FRS 102 requires entities to disclose the nature and extent of an entity's interest in unconsolidated special purpose entities, and the risks associated with those interests, in their consolidated financial statements.

B18 If the definition of control in Section 9 is aligned with IFRS 10, we would recommend that transitional relief is provided so that entities with simple and stable structures do not need to reassess whether they control an investee. In such instances it should be apparent that the financial reporting boundary has not changed. However, reassessment of control should be required when an entity operates as part of more complex and continually changing structure.

Retaining and updating paragraph 9.5 of the IFRS for SMEs Standard

B19 We support retaining the simplification in paragraph 9.5, irrespective of whether the definition of control in Section 9 is aligned with IFRS 10. The 'indicators of control' listed in the paragraph provide a simplification for preparers which is in keeping with the purpose of the standard.

Question S2B — Investment entities
What are your views on not introducing the requirement that investment entities measure investments in subsidiaries at fair value through profit and loss?

B20 We support introducing the requirement for investment entities to measure investments in subsidiaries at fair value through profit and loss.

B21 The outcome of applying this requirement is considered to achieve the most appropriate accounting treatment in the consolidated financial statements of investment entities when investments in subsidiaries are held solely for returns. Requiring investment entities to consolidate such subsidiaries does not reflect the entities' purpose and how they manage these investments.

B22 This requirement is incorporated within Section 9 of FRS 102. The scope of entities eligible to apply FRS 102 includes those that would qualify as investment entities as defined by IFRS 10. Therefore, as the requirement is relevant to entities applying the standard, a similar requirement has been introduced.

B23 If the requirement is introduced, we recommend that it is 'carried through' so it can be applied by a parent entity that does not qualify as an investment entity but holds a single investment in a subsidiary which is an investment entity. This covers those scenarios where an entity has an investment portfolio which is indirectly held through an investment fund. Without extending the application of this requirement, the entity would have to include its interest in the investment fund as part of its consolidated financial statements. This treatment is not considered to reflect the parent's intention in holding an interest in the subsidiary.

Question S3A — Classification and measurement of financial assets
What are your views on supplementing the list of examples in Section 11 with a principle for classifying financial assets based on their contractual cash flow characteristics?

B24 We support the proposal to supplement the list of examples in Section 11 *Basic Financial Instruments* with a principle for classifying financial assets. This approach is more closely aligned with IFRS 9 *Financial Instruments*. It helps overcome the difficulties associated with a rules-based approach to classifying financial assets by setting a boundary for more complex financial instruments that allows entities to apply judgement to assess whether the substance of an instrument results in it being included within it.

B25 The original requirements in FRS 102 covering the classification of financial assets were equivalent to the *IFRS for SMEs* Standard. However, stakeholder feedback indicated that entities were encountering significant problems when applying the classification conditions in paragraph 11.9. Examples were discussed of specific financial instruments that did not meet these conditions, but where obtaining a fair value was not considered to provide helpful information to users of financial statements.

B26 To address this issue, we introduced a principle-based description of a 'basic' financial instrument. The principle is based on the contractual cash flow characteristics and mirrors the wording of IFRS 9. The description is considered only in those circumstances when debt instruments do not meet the conditions in paragraph 11.9. We have also made changes to some of the conditions in paragraph 11.9 and added new accompanying examples to reflect the conditions and the features of the description.

B27 This approach retains the classification conditions (and examples) but establishes an overriding requirement for entities to apply judgement by considering the principle for the classification of 'basic' financial instruments when the conditions in paragraph 11.9 are not met.

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

B28 It is not clear whether the Board intends the scope of the simplified approach in IFRS 9 to be extended and applied to all financial assets on alignment. Paragraphs B36 to B37 of the Request for Information does not make this explicit. Despite this, we support aligning the *IFRS for SMEs* Standard with the simplified approach to the impairment of financial assets in IFRS 9, including extending the scope of this approach to apply to all financial assets.

B29 The expected credit loss model represents an improvement to financial reporting. The model reflects current thinking about how entities should recognise impairment losses in a way that best reflects the economic link between the pricing and credit quality of financial assets. By retaining requirements based on an incurred loss model, the *IFRS for SMEs* Standard will not reflect a model of accounting that is widely regarded as better aligned with the objective of financial reporting.

B30 The general approach for impairment in IFRS 9 does not appear to be appropriate based on the scope of entities eligible to apply the *IFRS for SMEs* Standard. We agree that the simplified approach offers a more appropriate basis for alignment with IFRS 9.

Question S3C — Hedge accounting
(a) Do you consider Section 12 needs to include requirements on hedge accounting? **(b) If your answer is yes, what are your views on retaining the current requirements to address the needs of entities applying the Standard, rather than aligning Section 12 with IFRS 9?** **(c) If your answer is no, please explain the reasons for your answer.**

Requirements on hedge accounting

B31 We support retaining requirements on hedge accounting in Section 12 *Other Financial Instruments Issues*. Without these requirements, an entity which enters into an economic hedge is not able to account for the transaction using hedge accounting resulting in more volatility in the entity's financial statements, which does not faithfully reflect the economic reality of the transaction and the entity's risk management strategy.

B32 Section 12 *Other Financial Instruments Issues* of FRS 102 includes requirements for hedge accounting. The scope of entities eligible to apply FRS 102 includes those more likely to use hedging as part of their risk management strategy, for example some financial institutions. However, we understand that entities which would be included within the scope of the *IFRS for SMEs* Standard also use hedging to manage risks associated with particular activities. Therefore, hedge accounting requirements are necessary to accommodate these entities.

Aligning Section 12 with IFRS 9

B33 We support Section 12 being aligned with IFRS 9.

B34 IFRS 9 expanded the scope of permissible hedged items and hedging instruments and made the conditions for hedge accounting less complex. Retaining the current requirements of Section 12 will mean the *IFRS for SMEs* Standard will not reflect up-to-date thinking and changes made to IFRS in order to improve the application of hedge accounting.

B35 Section 12 of FRS 102 was amended in 2014 to incorporate the hedge accounting requirements of IFRS 9 instead of those of the *IFRS for SMEs* Standard. The amendments were made to make the existing hedge accounting requirements of FRS 102 easier and more cost effective to apply. They simplified the requirements of IFRS 9 in order to recognise that this standard deals with hedging transactions that are more complex than those typically entered into by entities applying FRS 102. This is one potential option for alignment.

Question S3D — Using recognition and measurement requirements in IFRS Standards for financial instruments
(a) **Are you aware of entities that opt to apply the recognition and measurement requirements of IAS 39 with the disclosure requirements of Sections 11 and 12?** **(b)** **What are your views on changing the reference to IAS 39 to permit an entity to opt to apply the recognition and measurement requirements of IFRS 9 and the disclosure requirements of Sections 11 and 12?**

Entities that opt to apply the recognition and measurement requirements of IAS 39

B36 FRS 102 includes the option to apply the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement* with the disclosure requirements of Sections 11 and 12. We understand that a significant majority of UK building societies use this option in order to have access to the macro hedging requirements of IAS 39.

B37 The application of this option may be a consequence of the scope of entities eligible to apply FRS 102, which includes entities that have publicly accountability as defined by the *IFRS for SMEs* Standard.

Changing the reference to IAS 39 to permit an entity to opt to apply the recognition and measurement requirements of IFRS 9

B38 We support changing the reference to IFRS 9.

B39 Financial instruments are now being accounted for under IFRS 9. As experience of the standard grows, it makes sense that the option to apply the recognition and measurement requirements of IFRS 9 is available through the *IFRS for SMEs* Standard. Entities should be provided with the flexibility to apply IFRS 9 without delay should they wish to do so.

B40 We also support this option being available irrespective of the Board's decision to align other areas of Sections 11 and 12 of the *IFRS for SMEs* Standard with IFRS 9 (as discussed in questions S3B, S3C and S3E).

B41 We note that on IFRS 17 *Insurance Contracts* becoming effective, IAS 39 will no longer be applicable for insurers. Therefore, by retaining the reference to IAS 39, the standard will need to be maintained solely for this option in the *IFRS for SMEs* Standard.

B42 If the reference is changed to IFRS 9, we recommend that the Board considers the consequence of this change on the disclosure requirements in Section 11. We amended FRS 102 to provide entities with the option to apply the recognition and measurement requirements of IFRS 9, and we also made minor amendments to the disclosure requirements in Section 11 to ensure that entities that apply this option provide relevant information about the impairment of financial assets.

Question S3E — Treatment of Q&As on the *IFRS for SMEs* Standard
What are your views on: **(a) adding the definition of a financial guarantee contract from IFRS 9 to the *IFRS for SMEs* Standard; and** **(b) aligning the requirements in the *IFRS for SMEs* Standard for issued financial guarantee contracts with IFRS 9?**

B43 We support including the IFRS 9 definition of a financial guarantee contract in the *IFRS for SMEs* Standard. We understand these contracts are issued by entities eligible to apply the Standard, as indicated by the SMEIG's decision to publish Q&A 2017/12.1.

B44 We also support aligning the requirements in the *IFRS for SMEs* Standard for issued financial guarantee contracts with IFRS 9. The accounting treatment for these contracts under IFRS 9 is less complex compared to the requirements of the *IFRS for SMEs* Standard. Therefore, the treatment supports the aim of developing a standard that provides simplifications compared to full IFRS Standards.

B45 FRS 102 also includes the IFRS 9 definition of a financial guarantee contract. However, FRS 102 requires an entity to account for issued financial guarantee contracts by applying the requirements in Section 21 *Provisions and Contingencies*, unless the reporting entity chooses to apply the recognition and measurement requirements of IAS 39 or IFRS 9. This treatment offers a simplification from the current requirements of both the *IFRS for SMEs* Standard and full IFRS Standards by removing the requirement for these contracts to be recognised initially at fair value. Instead the contract is measured at the best estimate of the amount required to settle the obligation at the reporting date and is only then updated when an outflow of resources becomes probable (i.e. there is a valid claim under the contract). The existence of a guarantee would be disclosed as a contingent liability.

B46 Our decision to include financial guarantee contracts within the scope of Section 21 was made to maintain consistency with the accounting treatment that existed under previous UK GAAP. We are not aware of this treatment not working in practice.

Question S4 — Aligning Section 15 *Investments in Joint Ventures* of the *IFRS for SMEs* Standard with IFRS 11 *Joint Arrangements*
What are your views on: **(a) aligning the definition of joint control in Section 15 with IFRS 11?** **(b) retaining the categories of joint arrangements: jointly controlled operations, jointly controlled assets and jointly controlled entities?** **(c) retaining the accounting requirements of Section 15, including the accounting policy election for jointly controlled entities in Section 15?**

Aligning the definition of joint control in Section 15 with IFRS 11

B47 We do not recommend aligning the definition of joint control in Section 15 *Investments in Joint Ventures* with IFRS 11 *Joint Arrangements*. As with the definition of control in Section 9, we consider the existing definition to provide a boundary for financial reporting that is generally understood within the context of entities eligible to apply the *IFRS for SMEs* Standard.

B48 The definition of joint control introduced by IFRS 11 was generally considered as not having a significant impact when applied in practice. Stakeholder feedback has indicated that for entities with simple structures and joint arrangements, implementing the change involved a large amount of work, but had a limited impact on their financial reporting.

B49 Our recommendation is based the implementation experience of entities with uncomplicated and stable structures. This is an attribute of SMEs that is generally assumed to be true. However, the IASB may wish to conduct outreach to confirm this assumption.

Retaining the categories of joint arrangements: jointly controlled operations, jointly controlled assets and jointly controlled entities

B50 We support retaining the categories of joint arrangements in Section 15.

B51 Implementation experience indicates that classifying the type of joint arrangement under IFRS 11 has been challenging for preparers. We would expect that these challenges would be amplified if the requirements of Section 15 are aligned with IFRS 11.

B52 Interests in jointly controlled assets are likely to be reclassified as joint operations under IFRS 11. This reclassification would be expected to result in limited changes that would not have a significant impact on entities' financial reporting. As described in paragraph B48, there is a risk that alignment with IFRS 11 will involve a large amount of work for little practical impact. Therefore, the relative benefits to users of making this change are not considered to outweigh the expected cost to preparers.

Retaining the accounting requirements of Section 15, including the accounting policy election for jointly controlled entities in Section 15

B53 Amending Section 15 to require entities to apply the equity method to account for investments in jointly controlled entities would mean the options to apply the cost model or fair value model would no longer exist.

B54 FRS 102 requires venturers that are parents to use the equity method to account for investments in jointly controlled entities in their consolidated financial statements, except when these investments are held as part of an investment portfolio where the fair value model is applied. We consider this treatment to best reflect the nature of the parent's relationship with the entity.

B55 The option for venturers to use the cost model in Section 15 of the *IFRS for SMEs* Standard was introduced to accommodate preparers who had difficulty applying the equity method. The requirements of UK company law meant that UK GAAP required venturers to apply the equity method in their consolidated financial statements prior to the introduction of FRS 102. Based on this experience, we are not aware of preparers having trouble when applying the method, nor of there being a need to introduce an alternative, more straightforward method. Therefore, we consider removing the options for the cost and fair value models would be in keeping with the purpose of the Standard.

B56 However, we believe permitting a more straightforward method of accounting for entities investments in jointly controlled entities in their individual financial statements remains appropriate. The option to apply the cost model or fair value model is also consistent with the accounting policy election currently available for accounting for investments in subsidiaries and associates in the *IFRS for SMEs* Standard. Therefore, we do not support venturers being required to use the equity method in their individual financial statements.

Question S5A — Aligning Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs* Standard with IFRS 3 (2008) *Business Combinations*
(a) Do you consider Section 19 needs to include requirements for the accounting for step acquisitions? **(b) If your answer is yes, should the requirements be aligned with IFRS 3 (2008).**

Accounting for step acquisitions

B57 We support the introduction of requirements for the accounting for step acquisitions.

B58 Section 19 *Business Combinations and Goodwill* of FRS 102 includes requirements that address accounting for step acquisitions. We understand these requirements are applied in practice. Therefore, we consider this form of business combination to be relevant to entities applying the *IFRS for SMEs* Standard.

B59 This would help ensure greater consistency and comparability in how entities account for these business combinations and may provide more useful information to users of the financial statements of SMEs.

Alignment with IFRS 3 (2008)

B60 We note that the requirements of IFRS 3 (2008) *Business Combinations* differ from FRS 102.

B61 The accounting treatment under FRS 102 reflects the requirements of UK Company Law, which permits the calculation of goodwill in a business combination to be performed only once: at the date that control is achieved. As a result, FRS 102 does not require the acquirer to remeasure any previously held equity interests in the acquisition to fair value when calculating goodwill at the acquisition date.

B62 Under IFRS 3 (2008), the acquirer is required to make a retrospective assessment of the fair value of any previously held equity interest when calculating goodwill. However, we do not consider this additional requirement to be unnecessarily complex for SMEs. This requirement ensures that the fair values of the consideration given, and net assets acquired, are measured on a consistent basis (i.e. on same date).

B63 Therefore, we recommend the requirements are aligned with IFRS 3 (2008).

Question S5B — Aligning Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs* Standard with IFRS 3 (2008) *Business Combinations*
What are your views on aligning Section 19 with IFRS 3 (2008) for acquisition costs and contingent consideration, including permitting an entity to use the undue cost or effort exemption and provide the related disclosures if measuring contingent consideration at fair value would involve undue cost or effort?

Acquisition costs

B64 We do not consider the treatment of acquisition-related costs under IFRS 3 (2008) to be any more complex than the existing treatment in Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs* Standard. Therefore, the accounting requirements of Section 19 would not be made any simpler (or complex) on alignment with IFRS 3 (2008).

B65 However, we do not support alignment as we do not consider the treatment of acquisition-related costs under IFRS 3 (2008) to reflect an improvement to the information available to users of financial statements. We stated this in our responses during the development and implementation of IFRS 3. Recognising these costs separately as an expense also conflicts with the treatment of similar costs when accounting for purchases of property, plant and equipment and non-controlling equity investments.

Contingent consideration

B66 We discuss the application of the undue cost or effort exemption in our response to Question S1. Given the potential complexity of measuring contingent consideration at fair value, we consider that there is a risk that entities will lapse into treating this exemption as an accounting policy choice. This could mean that entities choose to disclose information about contingent liabilities instead of attempting to estimate their fair value. By making this choice, entities may not recognise contingent liabilities in those situations when their fair value can be measured reliably. In such instances a contingent liability would be recognised under the current requirements of Section 19.

B67 Therefore, we do not consider that the information available to users of financial statements would be improved by aligning Section 19 with IFRS 3 (2008) when this involves permitting entities to use the undue cost or effort exemption. We recommend that the current requirements for the recognition of contingent consideration are not amended.

Recognition criteria for recognising an intangible asset acquired in a business combination

B68 Section 19 requires entities to recognise intangible assets acquired in a business combination unless their fair value cannot be measured reliably without undue cost or effort at the acquisition date.

B69 We discuss the application of the undue cost or effort exemption in our response to Question S1. Based on stakeholder feedback about the general application of this exemption, we consider that there is a risk that entities may not separately recognise intangible assets acquired in a business combination in those situations when their fair value can be measured reliably. Instead, these intangible assets will be subsumed as part of goodwill, providing users of financial statements with less information about these assets.

B70 IFRS 3 (2008) requires all intangible assets acquired in a business combination to be recognised separately from goodwill. There is a risk that the undue cost or effort exemption results in information that is significantly different from that provided under IFRS 3 (2008).

B71 One potential option for alignment would be to introduce a requirement partially derived from the assumption in IFRS 3 (2008) that if an intangible asset is separable or arises from contractual or other legal rights, the reliable measurement criterion is always satisfied.

B72 This approach is currently used in FRS 102, which requires entities to recognise intangible assets separately from goodwill when all three of the following conditions are met:

(a) the recognition criteria are met (i.e. that it is probable that economic benefits will flow and the value of the asset can be measured reliably);

(b) the intangible asset arises from contractual or other legal rights; and

(c) the intangible asset is separable.

B73 Entities are therefore required to recognise some but not all intangible assets acquired in a business combination separately from goodwill.

B74 Entities also have the option to recognise, separately from goodwill, intangible assets that meet the recognition criteria ((a) above) and only one of the other two conditions). This choice permits the separate recognition of a larger number of intangible assets when this information provides useful information to the reporting entity and the users of its financial statements.

Question S5C — Definition of a business
What are your views on aligning the *IFRS for SMEs* Standard with the amended definition of a business issued in October 2018?

B75 We support aligning the *IFRS for SMEs* Standard with the amended definition of a business.

B76 As noted in our response to Question G1B, we consider the alignment of both principles and important definitions to be the most useful approach for aligning the *IFRS for SMEs* Standard with full IFRS Standards. Consistency with the definition of a business in IFRS 3 reduces any possibility of confusion amongst preparers and users familiar with full IFRS Standards.

B77 We also consider that the amended definition provides greater clarity, therefore reducing the level of judgement involved in determining whether a transaction should be treated either as a business combination or an asset acquisition. To this extent, alignment would make the *IFRS for SMEs* Standard easier to apply.

Question S6 — Aligning Section 20 *Leases* of the *IFRS for SMEs* Standard with IFRS 16 *Leases*
What are your views on aligning Section 20 with IFRS 16, making the simplifications listed in paragraphs (a)–(c)?

B78 We support aligning Section 20 *Leases* of the *IFRS for SMEs* Standard with IFRS 16 *Leases*. The requirements of IFRS 16 make the obligations associated with an entity's lease arrangements more visible. Leases are an important source of finance for SMEs. It is therefore appropriate that lease obligations are visible to the users of financial statements prepared under the *IFRS for SMEs* Standard.

B79 We consulted on aligning FRS 102 with IFRS 16 in 2016. Stakeholder feedback indicated general support for amending Section 20 *Leases* to reflect the principles of IFRS 16. However, it was felt that greater evidence gathering and analysis should be undertaken to inform the timetable and approach for doing so, taking into account the implementation experience of IFRS reporters. Given the amount of experience now available, we support the IASB's proposal to amend the *IFRS for SMEs* Standard as part of the review.

B80 We also note that lenders are becoming increasingly familiar with the model for accounting for leases in IFRS 16. By delaying the consideration of how to update the *IFRS for SMEs* Standard with IFRS 16, the *IFRS for SMEs* Standard risks no longer representing up-to-date thinking about how to account for leases. This creates an unintentional gap between the accounting practices applied by SMEs and IFRS reporters.

B81 The prevalence of lease financing amongst SMEs means aligning Section 20 with IFRS 16 will impact a substantial proportion of entities that apply the *IFRS for SMEs* Standard. Therefore, developing ways that the requirements of IFRS 16 can be simplified so they are easier and less costly for entities on transition should be a key consideration for the Board.

(a) simplifying recognition and measurement requirements in respect of matters such as variable lease payments, determining the discount rate and the term of the lease

B82 Stakeholder feedback indicates that several of the most challenging aspects of IFRS 16 are encountered by preparers when gathering the information needed to initially apply the lessee accounting model (e.g. determining the lease term and discount rate and measuring the right-of-use asset). Once gathered, preparers are generally comfortable with subsequent accounting, as it is similar in substance to the accounting for finance leases in IAS 17 *Leases*.

B83 We expect this to be the experience of entities applying the *IFRS for SMEs* Standard. Therefore, we recommend that the Board focuses on how the requirements associated with the initial application of the model can be simplified in aligning Section 20 with IFRS 16. This includes considering transitional relief, which we believe should be provided on the same basis as in IFRS 16. Whilst we agree that there is scope to simply the requirements in respect of variable lease payments and other changes in lease payments, these changes usually occur relatively infrequently in practice and are typically one-off events.

Variable lease payments

B84 We agree that there is scope to simplify the requirements of IFRS 16 by extending those changes that are accounted for as variable lease payments, as described in paragraph B71(c) of the Request for Information, rather than requiring the lease to be remeasured. However, we also recommend considering whether changes in lease payments could continue to be accounted for by applying the requirements of Section 11 of the *IFRS for SMEs* Standard, as is currently the case for any substantial modifications to the terms of a finance lease agreement. Retaining this approach may be a simpler alternative compared to the introduction of specific requirements covering these changes.

Determining the discount rate

B85 We support simplifying the requirements associated with determining the discount rate. Implementation experience indicates that this aspect of the IFRS 16 has been one of the most challenging for preparers. Permitting entities to use a proxy when both the interest rate implicit in the lease and the lessee’s incremental borrowing rate cannot be readily determined would be a significant simplification, as described in paragraph B71(a) of the Request for Information.

B86 Market yields on high-quality corporate bonds represents one such proxy, however, others may exist. Therefore, we recommend that entities are not restricted from using a discount rate by reference to an alternative source when this serves as a more suitable proxy. For example, if the interest rate implicit in the lease and the lessee’s incremental borrowing rate cannot be readily determined, there could be a rebuttable presumption an entity will use this proxy.

Term of the lease

B87 The proposed definition of the lease term in paragraph B71(b) of the Request for Information removes the requirement to consider any options the lessee has to extend or terminate the lease. When such options exist, this simplification to the definition may result in all or a portion of the lease liability not being recognised in the balance sheet. In these instances, the definition could result in accounting which does not faithfully represent the substance of the lease arrangement and does not provide useful information to users of financial statements.

B88 Whilst we agree there is merit in considering simplifying the requirements associated with determining lease terms, we recommend that further consideration is given to the implications of this proposal, particularly for assets leased on rolling contracts which may continue indefinitely (e.g. renewable leases). In these instances, we consider the proposed definition is an over-simplification. As entities seek flexible leasing arrangements, these types of contracts may become more relevant to SMEs. Therefore, it is important that the substance of these contracts is reflected the financial statements of those entities applying the *IFRS for SMEs* Standard.

(b) retaining the disclosure requirements of Section 20

B89 We support retaining the existing disclosure requirements of Section 20, which we consider as working well in practice. However, we recommend expanding them to provide information about lease payments for assets and liabilities which are not recognised in the balance sheet. Depending on the definition of ‘lease term’, this may include information on future cash outflows related to extension options or renewable leases that are not reflected in the measurement of lease liabilities.

(c) simplifying the language of the Standard

B90 We support simplifying the language of IFRS 16.

Question S7A — Aligning Section 23 *Revenue* of the *IFRS for SMEs* Standard with IFRS 15 *Revenue from Contracts with Customers*
Which of the three alternatives do you prefer for amending Section 23 to align with IFRS 15? Why have you chosen this alternative?

B91 We prefer the approach to alignment described in Alternative 1. This approach will help minimise the work needed by entities that apply the *IFRS for SMEs* Standard in transitioning to accounting for revenue in a way that reflects the principles of IFRS 15 *Revenue from Contracts with Customers*. It reflects an appropriate compromise between reflecting up-to-date thinking and the potential for adding complexity from full IFRS Standards.

B92 Stakeholder feedback suggests that the transition to IFRS 15 can involve a significant amount of work but result in limited changes to the amount and timing of revenue recognised. Our review of disclosures that covered the implementation of IFRS 15 found that the transition impact of adopting the standard was not material to nearly two thirds of companies sampled[2]. The sample included companies from industries that we expected to be significantly impacted by the implementation of IFRS 15. Therefore, steps should be taken when possible to avoid SMEs having to incur significant transition costs to implement changes that have a limited impact on their financial reporting.

B93 We support the proposal to rearrange Section 23 *Revenue* by introducing an overriding set of principles and elevating the status of the examples, as described in paragraph B74 of the Request for Information. The examples should aim to cover those types of revenue most common to entities within the scope of the Standard. This would mean entities having to apply the principles to develop an accounting policy for revenue recognition in a limited number of instances, which could lessen the practical impact of this change for entities on transition.

B94 If Section 23 is amended as described in paragraph B74 of the Request for Information, we recommend providing guidance that assists entities in identifying revenue streams where the amount and timing of revenue recognition is likely to change as a result of the new requirements (e.g. licensing agreements or bundles of goods or services sold as separate contracts). This could be developed by building on the implementation experience of entities on transition to IFRS 15. The guidance could take the form of factors that entities would consider before they decide to recognise revenue as they have done previously or revisit their existing revenue recognition policy.

B95 We also support the proposal to add new examples which cover the agent–principal distinction. We updated the guidance on this area in FRS 102 following stakeholder feedback which indicated it was not sufficiently clear.

[2] IFRS 15 Thematic Review: Review of Disclosures in the First Year of Application, 2019, FRC

Question S7B — Aligning Section 23 *Revenue* of the *IFRS for SMEs* Standard with IFRS 15 *Revenue from Contracts with Customers*
If Alternative 1 or Alternative 2 is the basis for an Exposure Draft, should transitional relief be provided: **(a) by permitting an entity to continue its current revenue recognition policy for any contracts already in progress at the transition date or scheduled to be completed within a set time after the transition date?** **(b) by some other method?** **(c) not at all?** **Please explain why you have chosen (a), (b) or (c) above.**

B96 We do not support providing transitional relief as described in Question S7B(a).

B97 The method described permits entities to continue with their previous revenue recognition policies, whilst applying new requirements that are considered to provide a more faithful representation of the same transactions. We do not consider this 'mixed' approach to be justified. The application of two different methods for revenue recognition also impairs the comparability of revenue between periods and entities, introducing complexity for users of financial statements. Therefore, to preserve the comparability of the revenue figure, we recommend an entity is required to reassess all contracts in progress at the transition date under the new requirements, when the requirements have changed. As suggested in paragraph B94, we believe that guidance could make it clear to preparers when the amount and timing of revenue recognised for specific revenue streams is likely to change.

B98 We also note that the suggested relief will be relevant only for those contracts already in progress at the transition date or scheduled to be completed within a set time after this date. In many cases, contracts with customers will be short-term and not in progress at the transition date. Therefore, this relief will not be relevant for all entities on transition. We believe aligning Section 23 of the *IFRS for SMEs* Standard with IFRS 15 by following the approach described in Alternative 1 would have a greater effect in minimising the costs on transition for entities applying the *IFRS for SMEs* Standard compared to this relief.

B99 We support providing transitional relief by allowing entities to apply the modified retrospective approach, as permitted by IFRS 15. For many entities applying IFRS 15, this approach has provided a simpler alternative to the full retrospective approach. Our review of disclosures that covered the implementation of IFRS 15 found the modified retrospective approach was applied by more companies in our sample compared to the full retrospective approach[3]. Therefore, we would expect this option to be used by entities applying the *IFRS for SMEs* Standard if made available.

[3] IFRS 15 Thematic Review: Review of Disclosures in the First Year of Application, 2019, FRC

Question S8 — Aligning Section 28 *Employee Benefits* of the *IFRS for SMEs* Standard with IAS 19 (2011) *Employee Benefits*
What are your views on aligning Section 28 with the 2011 amendments to IAS 19 only in respect of the recognition requirements for termination benefits?

Recognition of termination benefits

B100 The scope of Section 21 *Provisions and Contingencies* of FRS 102 was amended to include employee benefit obligations. Therefore, entities applying FRS 102 are required to provide for the payment of termination benefits by applying the recognition criteria in Section 21, irrespective of whether they are to be paid as part of restructuring or not. We consider that the point of recognition for termination benefits under Section 21 is similar compared to applying the recognition requirements in IAS 19 *Employee Benefits*. For this reason, no changes have been made to Section 28 *Employee Benefits* of FRS 102 to reflect this amendment to IAS 19.

B101 Based on the current scope of Section 21 *Provisions and Contingencies* of the *IFRS for SMEs* Standard, we agree that an amendment to Section 28 *Employee Benefits* is necessary to reflect this amendment to IAS 19. However, expanding the scope of Section 21 to include employment benefits obligations would achieve a similar outcome. We also believe this approach offers a simplification, as entities are able to apply the same recognition criteria for all termination benefits and are not required to consult a separate section of the Standard depending on whether the termination benefits are paid as part of restructuring or not. Therefore, we recommend this as an alternative approach to alignment.

Presentation of actuarial gains and losses

B102 We recommend the requirements for the presentation of actuarial gains and losses relating to defined benefits plans in Section 28 are aligned with IAS 19 (2011).

B103 As noted in paragraph B75 of the Request for Information, the Board sought views on aligning Section 28 in with IAS 19 as part of the first comprehensive review of the *IFRS for SMEs* Standard in 2012. A majority of respondents favoured adopting this change on the basis that it would result in comparability with full IFRS Standards without increasing complexity. However, no amendment was made to Section 28 as the implementation experience for these amendments to IAS 19 had yet to be assessed. It is now over nine years since IAS 19 was amended and the option to present actuarial gains and losses in profit or loss was removed. We consider this amendment has improved the quality of pension accounting, and the presentation requirements better reflect the nature of this transaction.

B104 On revisiting this issue as part of the review, we understand the IASB's decision not to seek views on this amendment was based on a preference for allowing accounting practices which exist at a national level to continue. We consider that this reason for retaining the current requirements is inadequate.

B105 The current option to present actuarial gains and losses in either profit or loss or other comprehensive income allows scope for diversity in where entities present these items. We believe that removing the option would result in greater consistency and comparability amongst entities applying the *IFRS for SMEs* Standard. It would also reduce the number of options available in the *IFRS for SMEs* Standard, making it easier for entities to apply.

Question S9 — Aligning the *IFRS for SMEs* Standard with IFRS 13 *Fair Value Measurement*
What are your views on: **(a) aligning the definition of fair value in the *IFRS for SMEs* Standard with IFRS 13?** **(b) aligning the guidance on fair value measurement in the *IFRS for SMEs* Standard with IFRS 13 so the fair value hierarchy incorporates the principles of the fair value hierarchy set out in IFRS 13?** **(c) including examples that illustrate how to apply the hierarchy?** **(d) moving the guidance and related disclosure requirements to Section 2?**

Aligning the definition of fair value in the IFRS for SMEs Standard with IFRS 13

B106 We support aligning the definition of fair value with IFRS 13 *Fair Value Measurement*.

B107 As noted in our response to Question G1B, we consider the alignment of both principles and important definitions to be the most useful approach. Consistency with the definition of fair value in IFRS 13 reduces any possibility of confusion amongst preparers familiar with full IFRS Standards, where the fair value model is used extensively and the revised definition and related guidance is now embedded into how entities approach fair value measurement.

B108 We would expect the impact of aligning the definition of fair value in the *IFRS for SMEs* Standard to be minimal for those entities with simple structures and that do not hold complex financial instruments. However, there is a risk that these entities may struggle to understand the subtle differences between the current and revised definition. Therefore, if the definition of fair value is aligned with IFRS 13, we would recommend that guidance on the impact these changes may have is available for entities applying the *IFRS for SMEs* Standard. This should build on the implementation experience of entities adopting IFRS 13.

B109 Implementation experience indicates that the information needed to allow entities to take account their own credit risk when measuring the fair value of a liability can be difficult to obtain. We recommend that consideration is given to whether this aspect of the definition could be simplified if aligned with IFRS 13. When information cannot be obtained to allow the amount of change attributable to an entity's own credit risk to be measured reliably, entities could be required to disclose whether the risk has been incorporated (i.e. it is assumed that the entity will have the ability to settle the liability), or if it has not been updated since initial recognition. This simplification could avoid the introduction of a definition that is too difficult for preparers to apply in practice, and minimise the loss of information to users when the fair value of a liability does not reflect the effect of the entity's own credit risk.

Aligning the guidance on fair value measurement in the IFRS for SMEs Standard with IFRS 13

B110 We support incorporating the principles of the fair value hierarchy in IFRS 13 into a methodology for approaching fair value measurement. The 'ranking' of inputs that the hierarchy establishes would help entities measure assets and liabilities using the most reliable information. We agree that this could achieve greater consistency in the measurement of fair value, as well as making the guidance easier and understand and apply.

B111 However, we do not support this being used to determine the disclosures required by an entity, as it is in IFRS 13. We consider that replicating the extensive disclosures required by IFRS 13 would go against the aim of the *IFRS for SMEs* Standard.

Including examples that illustrate how to apply the hierarchy

B112 The current *IFRS for SMEs* Standard does not include examples that illustrate fair value measurement. Examples would increase the length of the guidance on measuring fair values, contributing to the material preparers must consult when applying this model. In addition, applying the fair value model is perceived by many preparers as complex and costly. Lengthy guidance which covers this area would further this perception.

Moving the guidance and related disclosure requirements to Section 2

B113 We support moving the guidance on fair value measurement to Section 2 *Concepts and Pervasive Principles*. The *IFRS for SMEs* Standard permits or requires measurement at fair value for several non-financial assets and liabilities. Therefore, this guidance is of general application and is not only relevant to financial instruments.

B114 However, we do not support moving the related disclosures to Section 2, nor introducing general disclosure requirements for all items measured at fair value. Measurement is one aspect of accounting and will not always be the most important aspect of the disclosure. Retaining these requirements within the relevant sections of the *IFRS for SMEs* Standard provides scope for these disclosures to be tailored to the items as necessary.

Question S10 — Aligning multiple sections of the *IFRS for SMEs* Standard for amendments to IFRS Standards and IFRIC Interpretations
What are your views on: **(a) aligning the *IFRS for SMEs* Standard with the amendments to IFRS Standards outlined in Table A1 of Appendix A?** **(b) leaving the *IFRS for SMEs* Standard unchanged by the amendments to IFRS Standards listed in Table A2 of Appendix A?** **(c) whether to align the *IFRS for SMEs* Standard with the amendments to IFRS Standards and IFRIC Interpretations listed in Table A3 of Appendix A?** **Please explain your views and provide any relevant information in support of your views.**

Aligning the IFRS for SMEs Standard with the amendments to IFRS Standards outlined in Table A1

B115 We agree with aligning the *IFRS for SMEs* Standard with the amendments to IFRS Standards in Table A1, except for the following four amendments.

Transfers of Investment Property (Amendments to IAS 40)

B116 The Amendments to IAS 40 *Investment Property* provide clarity on when an entity should transfer property to, or from, investment property. We are not aware of this being an issue for entities that apply the *IFRS for SMEs* Standard. Therefore, aligning the Standard with these amendments would add detail on a topic that we do not consider to be necessary.

B117 In addition, the *IFRS for SMEs* Standard does not include the concept of 'change in use', despite this concept having featured in IAS 40 since it was first issued. Alignment would introduce this concept into the *IFRS for SMEs* Standard, which currently provides a simplification from the requirements of full IFRS.

B118 If the *IFRS for SMEs* Standard is aligned with the Amendments to IAS 40, we recommend that Section 16 *Investment Property* is amended to cover the measurement of transferred property and treatment of any measurement differences. This leads on from the transfer of property to, or from, investment property, but is currently not included in the *IFRS for SMEs* Standard. This issue was raised by stakeholders and addressed in recent amendments to Section 16 *Investment Property* of FRS 102, which introduced requirements based on IAS 40.

Clarification of Acceptable Methods of Depreciation and Amortisation *&* ***Clarification of Acceptable Methods of Depreciation and Amortisation*** (Amendments to IAS 16 and IAS 38)

B119 We are not aware of revenue-based methods of depreciation or amortisation being used by entities applying the *IFRS for SMEs* Standard. Therefore, aligning Section 17 and Section 18 *Intangible Assets other than Goodwill* for these amendments would add additional detail on an issue which is not relevant to most entities applying the Standard.

Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)

(a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments

B120 This clarification provided by these amendments may be relevant to entities applying the *IFRS for SMEs* Standard. However, we are not aware of preparers taking different approaches when estimating the fair value of cash-settled share-based payments compared to equity-settled share-based payments. Therefore, we do not consider that including guidance on this topic as part of the *IFRS for SMEs* Standard is necessary.

B121 In addition, the requirements that cover the accounting for different variations and combinations of share-based payments cannot all be covered in a standard which aims to be shorter and simpler than full IFRS. Instead, the *IFRS for SMEs* Standard should include the basic requirements necessary to allow these transactions to be accounted for in a way that does not impede faithful representation. We believe the requirements in Section 26 *Share-based Payments* fulfil this purpose, and it is not necessary for it to be aligned with these amendments.

Suggestions for aligning the IFRS for SMEs Standard with the amendments to IFRS Standards outlined in Table A1

B122 Our suggestions on amending the *IFRS for SMEs* Standard to align with specific amendments outlined in Table A1 are set out below.

Disclosure Initiative (Amendments to IAS 7)

B123 The disclosure requirement introduced by the Amendments to IAS 7 *Statement of Cash Flows* is based on an objective that entities must determine how to fulfil. This requirement could be simplified in the *IFRS for SMEs* Standard by prescribing the disclosures that would meet this objective.

B124 A common way to fulfil this requirement is to provide a reconciliation between the opening and closing balances of liabilities arising from financing activities. This reconciliation could be expanded to include cash balances in addition to the borrowings of an entity arising from financing activities. Doing so would mean that the disclosure would provide details of the cash movements associated with these activities. We consider that this approach would provide more relevant information to users of SMEs financial statements, who are particularly interested in information about an entity's short-term cash flows and liquidity[4].

B125 These considerations featured in our approach to aligning FRS 102 with the Amendments to IAS 7. We introduced a requirement to disclose a net debt reconciliation that reconciles movements in a net balance comprising of an entity's borrowings, together with any related derivatives and obligations under finance leases, less any cash and cash equivalents. This disclosure was based on a requirement that existed under previous UK GAAP.

[4] Paragraph BC157, *IFRS for SMEs*: Basis for Conclusions, 2015

Annual Improvement to IFRSs 2010-2012 Cycle (IFRS 2)

B126 The separation of the definitions of 'performance condition' and 'service condition' from the definition of 'vesting condition' helps to draw a distinction between the concepts relevant to the recognition and measurement of share-based payments. Therefore, alignment with these aspects of the amendments to IFRS 2 Share-based Payment would make the *IFRS for SMEs* Standard easier to apply. However, as the key features of the amended definition of 'market condition' are contained within the definition of 'performance condition', we consider that alignment with this amendment would not add anything to the current definition in the *IFRS for SMEs* Standard.

B127 These considerations featured in our approach to aligning FRS 102 with the amendments to IFRS 2, where the definition of 'market condition' was left unchanged.

Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)

(b) share-based payment transactions with a net settlement feature for withholding tax obligations

B128 We consider that the relief provided by this exemption should be extended to all share-based payment arrangements with a net settlement feature.

B129 Specifically, we recommend removing the restriction in paragraph 33H(a) of IFRS 2 that prevents the exemption from being applied when there is no obligation on the entity under tax laws or regulations to withhold an amount for an employee's tax obligation associated with that share-based payment. This would extend the scope of the amendment to all arrangements where a net settlement feature exists, irrespective of whether the entity is obligated to operate such an arrangement or not.

B130 This would provide a further simplification by potentially allowing more entities to avoid having to account for the different components of these transactions differently (i.e. as a cash-settled share-based payment to the tax authority, and an equity-settled share-based payment to the employee). As the substance of the transactions are the same irrespective of whether an employer is required or chooses to operate the arrangement or not, we consider that extending the scope of the amendment would not impede faithful representation.

Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41)

B131 We consider that the relief this amendment provides could be extended to other measurement requirements in Section 34 *Specialised Activities* of the *IFRS for SMEs* Standard.

B132 Specifically, we recommend removing the distinction between bearer plants and other biological assets held for breeding purposes (e.g. livestock). This would provide a further simplification by allowing entities to use the same measurement model for both classes of assets. Given the economic similarities between these assets, we consider that this treatment would not impede faithful representation.

B133 More generally, we recommend that further consideration is given to the potential burden created by requiring entities to use the fair value model for all classes of biological assets and agricultural produce. We understand that entities engaged in agricultural activities often manage their businesses on the basis of cost information.

Therefore, requiring fair value information is potentially inconsistent with the way these businesses are managed.

B134 This is reflected in Section 34 *Specialised Activities* of FRS 102, which provides entities engaged in agricultural activities the choice between measuring biological assets using either the cost model or the fair value model. When an entity opts to use the cost model, it may also then measure the agricultural produce harvested from these biological assets at the lower of cost and estimated selling price less costs to complete and sell.

Leaving the IFRS for SMEs Standard unchanged by the amendments to IFRS Standards listed in Table A2

B135 We agree that the *IFRS for SMEs* Standard should be left unchanged for the amendments to IFRS Standards listed in Table A2, except for the following two amendments.

Disclosure Initiative (Amendments to IAS 1)

B136 The Amendments to IAS 1 *Presentation of Financial Statements* aim to improve the communication value of financial statement disclosures and simplify their preparation. Given their general applicability and aim, we consider that the Standard should be aligned with these amendments.

B137 We do not agree with the Board's proposal to leave the *IFRS for SMEs* Standard unchanged for these amendments in anticipation of future changes related to its Primary Financial Statements project. Doing so would be a missed opportunity to potentially improve the quality and relevance of the information presented in the financial statements of entities applying the *IFRS for SMEs* Standard. We acknowledge the Board's reservations at making significant amendments to Section 3 *Financial Statement Presentation* in view of the outcome of this project, but it would be some time before those amendments were likely to be considered in the context of the *IFRS for SMEs* Standard.

B138 One approach would be to limit the amendments to those that clarify the application of materiality. This approach was taken to aligning FRS 102 with the Amendments to IAS 1. Section 3 *Financial Statement Presentation* of the FRS 102 was updated to include guidance on the aggregation of information and the application of materiality where the standard requires specific disclosures.

Annual Improvements to IFRS Standards 2015–2017 Cycle (IAS 12)

B139 We support Section 29 *Income Tax* being aligned with the amendments to IAS 12 *Income Taxes*.

B140 The requirements covering the presentation of tax expenses in the *IFRS for SMEs* Standard differ from the equivalent requirements in IAS 12 that the amendments clarify. To determine where the tax expense should be presented, entities applying the *IFRS for SMEs* Standard must firstly determine the transaction or event that resulted in the tax expense. The tax expense is then recognised in the same component of total comprehensive income or equity as this transaction or event.

B141 Aligning the *IFRS for SMEs* Standard with the Amendments to IAS 12 would clarify that when applying these requirements to the tax expense associated with dividends payments, the underlying 'transaction' is those that generate the distributable profits, rather than the distributions themselves or how the income tax has arisen (e.g. related to the tax rules and the figures used to calculate the expense). This would assist preparers applying these requirements and make them easier to apply.

B142 In general, the income tax consequences of dividend payments will be recognised in profit or loss rather than equity. To reflect this principle and provide a simplification, we introduced an exception into FRS 102 which requires the tax effects of distributions to owners to be shown in profit or loss. This relieves preparers from having to determine the underlying transaction and component in the first instance. It also provides a general rule that can be applied to the tax effects of other distributions to owners. This is one potential option for alignment.

Whether to align the IFRS for SMEs Standard with the amendments to IFRS Standards and IFRIC Interpretations listed in Table A3

B143 Our comments on each of the amendments to IFRS Standards and the IFRIC Interpretations in Table A3 are set out below.

Annual Improvements to IFRS Standards 2011–2013 Cycle (IAS 40)

B144 We do not consider that including guidance on this topic as part of the *IFRS for SMEs* Standard is necessary.

B145 The clarification that the amendments to IAS 40 provide relates to a transaction that is not commonly encountered by SMEs. When this transaction is encountered by an entity applying the *IFRS for SMEs* Standard, the scope of Section 19 does not restrict the application of Section 16 when it applies. In addition, as these sections are contained within a single standard, we considered that preparers would be less inclined to view both as mutually exclusive. Therefore, the need for clarification about the interrelationship between these sections is not as pronounced compared to full IFRS.

IFRIC 21 *Levies*

B146 We do not consider that including guidance on this topic as part of the *IFRS for SMEs* Standard is necessary.

B147 We consider material government levies are generally relevant to entities that operate in the financial services sector. These entities would not typically be within the scope of the *IFRS for SMEs* Standard. Although government levies are payable by entities operating in other sectors, they are less commonly encountered by SMEs.

B148 We have previously considered whether to amend FRS 102 to clarify the accounting treatment for levies but have chosen not to do so. Our decision has been informed by the relevance of these transactions for SMEs. We note in the absence of any specific guidance, generally accepted accounting treatments for levies has emerged based the existing requirements of FRS 102.

IFRIC 22 *Foreign Currency Transactions and Advance Consideration*

B149 We consider that including guidance on this topic as part of the *IFRS for SMEs* Standard would be helpful.

B150 IFRIC 22 provides clarity on what is the 'date of transaction' for the purpose of recording foreign currency transactions when consideration is received in advance. Advance payments arrangements are used by SMEs and may be entered into for goods or services bought or sold in a foreign currency. Therefore, these transactions may be encountered by entities applying the *IFRS for SMEs* Standard, and depending on their business models, may occur routinely.

B151 IFRIC 22 also covers an area of accounting that is generally considered by many preparers as complex. This complexity can be amplified when applying the requirements to more complicated foreign current transactions, for example advance payments. Therefore, clarifying the exchange rate that should be used for these specific transactions would make the Standard easier to apply.

IFRIC 23 *Uncertainty over Income Tax Treatments*

B152 We do not consider that including guidance on this topic as part of the *IFRS for SMEs* Standard is necessary.

B153 The transactions and circumstances of SMEs may result in uncertainties about the correct tax treatment. However, within the context of the UK, we consider that these uncertainties are predominately encountered by larger entities which would not be within the scope of the *IFRS for SMEs* Standard. This is attributed to these entities undertaking more complex transactions that give rise to contentious tax issues, where differing interpretations of the law and how it applies exist.

Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12)

B154 Aligning Section 29 for these amendments would potentially add a significant amount of detail on a topic that is relevant to only a small proportion of entities applying the *IFRS for SMEs* Standard. Therefore, we do not consider including guidance on this topic as part of the Standard is necessary.

Appendix C: Part C – Questions on new topics and other matters related to the *IFRS for SMEs* Standard

Question N1 — Aligning the *IFRS for SMEs* Standard with IFRS 14 *Regulatory Deferral Accounts*
What are your views on not aligning the *IFRS for SMEs* Standard with IFRS 14, that is, not including requirements for regulatory deferral account balances within the *IFRS for SMEs* Standard?

C1 We support not aligning the *IFRS for SMEs* Standard with IFRS 14 *Regulatory Deferral Accounts*.

C2 IFRS 14 is a temporary standard, issued in advance of the outcome of the Board's project on Rate-regulated Activities. Therefore, we consider that the Board should wait until this project is completed before introducing any guidance on accounting for regulatory deferral account balances in the *IFRS for SMEs* Standard, if necessary.

Question N2 — Cryptocurrency
Are holdings of cryptocurrency and issues of cryptoassets prevalent (that is, are there material holdings among entities eligible to apply the *IFRS for SMEs* Standard) in your jurisdiction?

C3 In the UK, entities that hold cryptocurrency are currently not required to be registered or provide any form of regulatory return. Therefore, no information is available that would indicate that material holdings of cryptocurrency are prevalent amongst entities applying FRS 102.

C4 Recent regulatory changes mean that businesses carrying out cryptoasset activity in the UK must register with the UK Financial Conduct Authority (FCA). These activities include the issue of cryptoassets. However, as the deadline for registration is yet to pass, information is not yet available that would indicate that material cryptoasset activity is prevalent amongst entities applying FRS 102.

C5 In the absence of any data points about the prevalence of cryptocurrency and cryptoassets amongst UK entities, anecdotal evidence suggests these are not typically held nor issued by entities applying FRS 102.

C6 FRS 102 includes no specific reference to the accounting for cryptocurrencies or cryptoassets. However, we understand entities generally account for holdings of cryptocurrencies by applying either Section 13 *Inventories* or Section 18 *Intangible Assets other than Goodwill* of FRS 102 (i.e. as inventories or intangible assets). This is consistent with the conclusions of the IFRS Interpretations Committee's agenda decision on the application of IFRS Standards to holdings of cryptocurrency.

C7 We note that in contrast to the *IFRS for SMEs* Standard, FRS 102 permits an option to use the revaluation model for the subsequent measurement of intangible assets. This means entities applying FRS 102 may use the revaluation model to account for holdings of cryptocurrency recognised as intangible assets. Therefore, the accounting for holdings of cryptocurrency under FRS 102 is generally consistent with full IFRS Standards.

C8 We understand that the IASB intends to decide whether to include requirements in the *IFRS for SMEs* Standard for cryptocurrency and cryptoassets based on the feedback received as part of this review. We do not support introducing separate requirements that explicitly address this area in the *IFRS for SMEs* Standard. Doing so would result in the *IFRS for SMEs* Standard 'jumping ahead' of the development of IFRS Standards. This is not in keeping with using the existing requirements of full IFRS Standards as the starting point for developing the *IFRS for SMEs* Standard.

C9 An alternative approach would be to introduce the revaluation model for the subsequent measurement of intangible assets based on IAS 38 *Intangible Assets*. We consider the revaluation option to be suitable for entities applying the *IFRS for SMEs* Standard. Although the model introduces a more complex option, it allows entities to use a measurement basis that provides users with more useful information about intangible assets for which an active market exists.

Question N3 — Defined benefit plans—simplifications allowed in measuring the defined benefit obligation
Are you aware of entities applying the simplifications allowed by paragraph 28.19 of the *IFRS for SMEs* Standard? If so, are you aware of difficulties arising in applying the simplifications? Please include a brief description of the difficulty encountered in applying the simplification.

C10 No. The simplifications allowed by paragraph 28.19 of the *IFRS for SMEs* Standard are not available in FRS 102. Section 28 *Employee Benefits* of FRS 102 requires entities to use the projected unit credit method to measure defined benefit obligations.

Question N4 — Other topics not addressed by the *IFRS for SMEs* Standard
Are there any topics the *IFRS for SMEs* Standard does not address that you think should be the subject of specific requirements (for example, topics not addressed by the Standard for which the general guidance in paragraphs 10.4–10.6 of the *IFRS for SMEs* Standard is insufficient)?

C11 We have no suggestions for additional topics that the *IFRS for SMEs* Standard should address.

Question N5 — Other topics not addressed by the *IFRS for SMEs* Standard
Please describe any additional issues you would like to bring to the Board's attention relating to the *IFRS for SMEs* Standard.

C12 The following issues concern requirements of FRS 102 that were originally equivalent to the *IFRS for SMEs* Standard but have been subsequently amended. We consider them relevant to the future development of the *IFRS for SMEs* Standard.

Section 11 *Basic Financial Instruments*

Non-derivative instruments that are equity of the issuer (Paragraphs 11.5(f), 11.8(d) and 11.14(c))

C13 Section 11 of the *IFRS for SMEs* Standard requires investments in non-convertible preference shares and non-puttable ordinary shares or preference shares to be measured at fair value (unless they cannot be measured reliably without undue cost or effort).

C14 This classification is based on the legal form of the instrument, rather than its substance. This creates an anomaly where certain preference shares that are liabilities of the issuer (and measured at amortised cost) are treated differently by the holder. Similarly, debt instruments with substantially the same terms are measured at amortised cost, rather than at fair value.

C15 FRS 102 was amended to remove the reference to shares. Instead, the classification refers to 'non-derivative financial instruments that are equity of the issuer'. This allows those instruments that are liabilities of the issuer to be measured at amortised cost (if that instrument is classified as 'basic'). This is aligned with the classification of financial instruments as either financial liabilities or equity, which is based on the substance of the contract rather than its legal form.

Reassessing classification subsequent to initial recognition

C16 Section 11 of the *IFRS for SMEs* Standard does not specify when the classification of financial instruments as 'basic' or 'other' should be revisited. Feedback indicated that preparers were uncertain if reclassification is required where there is a change in the contractual terms of a financial instrument, or if a feature of the contract which caused the debt instrument to not satisfy the conditions in paragraph 11.9 contractually expires after initial recognition.

C17 FRS 102 was amended to clarify that the reassessment of the classification of a financial instrument subsequent to initial recognition is not necessary unless the contract terms are modified. This aims to limit the instances when an entity is required to reassess the classification of their financial instruments.

Loans with two-way compensation clauses (Paragraphs 11.9(c) and 11.9B)

C18 Section 11 of the *IFRS for SMEs* Standard covers lending arrangements that include provisions for compensation to be paid to the lender should the borrower repay the loan early and current market interest rates are lower than the fixed rate specified in the agreement. This is covered by the condition in paragraph 11.9(c) and the example of a basic financial instrument in paragraph 11.9B. However, both paragraphs do not explicitly address provisions where compensation may be paid to the borrower by the lender. In the absence of guidance that specifically covered these provisions, there were divergent views as to whether loans with two-way compensation clauses should be classified as 'basic'.

C19 FRS 102 was amended to clarify that a provision which requires compensation to be paid by either the holder or the issuer does not in itself preclude debt instruments from being classified as basic financial instruments. These amendments align Section 11 with *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) but provide a simplification by encompassing both positive and negative compensation.

Section 14 *Investments in Associates* and Section 15 *Investments in Joint Ventures*

Undue cost or effort exemption when opting to measure at fair value (Paragraph 14.10 and 15.15)

C20 Sections 14 and 15 of the *IFRS for SMEs* Standard allow entities to choose either the cost model, equity method or fair value model to measure investments in associates and joint ventures. When an entity chooses to measure these investments using the fair value model, but the fair value of an investment cannot be measured reliably without undue cost or effort, it is measured using the cost model.

C21 We did not consider that it was necessary to permit entities that elect to use the fair value model to apply the undue cost or effort exemption when the option to use the cost model already exists. Practically, if an entity considers it to be too difficult or costly to determine the fair value of an investment, it may choose to use the cost model without having to apply this exemption. Therefore, the exemption was considered to serve no practical purpose.

C22 FRS 102 was amended to remove these exemptions from Sections 14 and 15. These amendments were informed by wider stakeholder feedback on the application of undue cost or effort exemption, as discussed in our response to Question S1.

Section 26 *Share-based Payment*

Share-based payment transactions with cash alternatives (Paragraph 26.15)

C23 Section 26 requires obligations arising from share-based payment transactions that contain a cash-settlement option to be accounted for as cash-settled share-based payment transactions, unless there is evidence of a past practice of settling in equity instruments or the cash-settlement option has no commercial substance. Therefore, in the absence of counterevidence, the default treatment is that of a cash-settled scheme. This differs from the equivalent requirements in IFRS 2 *Share-based Payment*, where the default treatment for these transactions is that of an equity-settled scheme.

C24 As cash-settlement accounting requires the measurement of the obligation at fair value at each reporting date, it was observed the general treatment of these transactions under Section 26 is more onerous than the requirements of full IFRS, under which they would generally be treated as equity-settled. This was considered as inconsistent with the aim of providing simplifications compared to the requirements of full IFRS.

C25 FRS 102 was amended to align the requirements of Section 26 for share-based payment transactions with cash alternatives with the equivalent requirements of IFRS 2. This had the effect of 'reversing' the default treatment in FRS 102. The standard now requires share-based payment arrangements with cash alternatives to be accounted for as equity-settled share-based payment arrangements, unless the entity has created a valid expectation that it would settle in cash or the equity-settlement option has no commercial substance.

Title of the *IFRS for SMEs* Standard

C26 Finally, we recommend that the Board reviews the appropriateness of the title of the *IFRS for SMEs* Standard.

C27 The definition of small and medium-sized entities in the Standard relies on the definition of 'public accountability', rather than prescribing quantitative size criteria. We agree with this principles-based approach, however, SMEs continue to be defined differently in different jurisdictions. Therefore, an entity's size is not a determining factor in whether it is publicly accountable and eligible to apply the Standard; indeed very large entities can be eligible to apply the standard. This can create confusion and misunderstanding.

C28 We recommend using the term 'non-publicly accountable' in the title of the Standard. What makes an entity 'non-publicly accountable' is clearly defined and more accurately reflects the intended scope of the Standard.

C29 We note that the reasons given the in Basis for Conclusion for using the term SMEs include the use of the term in the objectives of the IASC Foundation and the IASB[5]. As the objectives of the IASB and IFRS Foundation no longer include this term, we believe this justification and conclusion should be reconsidered.

[5] Paragraph BC79, *IFRS for SMEs*: Basis for Conclusions, 2015