

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

20 December 2012

Dear Sir/Madam,

Re: Request for Information: Comprehensive Review of the IFRS for SMEs

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Request for Information *Comprehensive Review of the IFRS for SMEs* (the RFI).

From its own discussions and from the comment letters received from constituents in response to its draft comment letter, EFRAG has learned that the purpose of the IFRS for SMEs and the objective of the RFI are unclear.

Some consider that the purpose of the IFRS for SMEs is to provide jurisdictions without a local GAAP for non-publicly accountable entities with a suitable complete stand alone standard. Others consider that the purpose is to establish a global standard for financial reporting for non-publicly accountable entities, which could facilitate financing and trade and bring comparability and consistency. Some note that the standard seems to be developed with an aim of reducing costs of preparing financial statements compared with full IFRS, but do not think that the standard explains under what circumstances the less costly financial statements are cost-benefit efficient considering users' needs. Another group of constituents thinks that the purpose of the standard could be to provide the basis on which national GAAP may be developed.

When answering the specific questions of the RFI, EFRAG has taken the view that the IFRS for SMEs should not serve as a differential disclosure regime for subsidiaries of listed groups, but respond to well identified needs and cost-benefit considerations for non-publicly accountable entities.

During EFRAG's due process, discussions held and comments received were consistent with the input received at the time the IFRS for SMEs was initially developed. Many constituents advocated that introducing or retaining options in the standard was necessary in maintaining within the IFRS for SMEs full consistency of the recognition and measurement requirements with full IFRS, while limiting the burden for subsidiaries of listed groups. EFRAG believes that the purpose of the IFRS for SMEs should not be to provide a regime for non-publicly accountable subsidiaries of listed parent companies with fewer disclosure requirements. EFRAG acknowledges, however, that the IASB should consider developing such a regime outside the IFRS for SMEs, as it would respond to a well identified need. As input for these considerations, the IASB could consult the work performed by the Financial Reporting Council of the United Kingdom on this issue.

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The objective of the RFI also seems unclear as it deals with both fundamental questions about the direction of the standard such as the scope of the standard and detailed requirements of the IFRS for SMEs. EFRAG has therefore been uncertain about whether the discussion on the scope and objective of the standard has now been re-opened.

The unclear purpose and objective have made it difficult to respond to the RFI. Answers to the detailed requirements of the IFRS for SMEs would in many cases depend on the purpose and the scope of the standard. Our first recommendation would therefore be to clarify the objective of the IFRS for SMEs.

EFRAG's comments to the specific questions reflect that it is not clear what are the needs of users of financial statements of small and medium-sized, non-publicly accountable entities.

According to paragraph BC95 of the Basis for Conclusions accompanying the IFRS for SMEs, the IFRS for SMEs was developed by:

- extracting the fundamental concepts from the *Framework* and the principles and related mandatory guidance from IFRS (Including Interpretations), and
- considering the modifications that are appropriate in the light of users' needs and cost-benefit considerations.

The IASB judged that this approach was appropriate because it considered the needs of users of financial statements of SMEs to be similar in many ways to the needs of users of financial statements of publicly accountable entities.

In the basis for conclusions to the *ED of a Proposed IFRS for Small and Medium-sized Entities*, the IASB acknowledged, however, that the information needs of users of the financial statements that will fall within the scope of the IFRS for SMEs would be different from those within the scope of full IFRS and that these differences should be reflected in different recognition and measurement principles. In its comment letter in response to the ED, EFRAG did not think these conclusions were fully taken into account in the decisions made by the IASB and encouraged the IASB to carry out some further analysis of the conclusions it had reached about the differences in users' needs.

EFRAG is not aware that further fundamental analyses of users' needs were conducted, and regrets this. EFRAG considers that these analyses could prove useful when deciding on future amendments of the IFRS for SMEs.

EFRAG believes that a situation where SMEs will have to spend resources on implementing changes that may result in only few or no benefits, or even result in unintended consequences, should be avoided. It also believes that stability is essential for SMEs.

In the absence of further analyses on users' needs, EFRAG's starting point, when answering the specific questions of the RFI, has therefore been that the IFRS for SMEs should only be changed when the suggested change addresses an identified problem for SMEs and the change is likely to solve that problem and thus results in improved financial reporting. Unless a change is considered particularly urgent, the change should only be incorporated into the IFRS for SMEs as part of the triennial review since SMEs have a strong demand for stability of the standard.

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EFRAG believes that all available and relevant information should be considered when suggesting changes. The relevant information includes, but is not limited to, identified problems and changes to full IFRS. Considering a broad range of information will potentially enable the IASB to identify and resolve an issue in the IFRS for SMEs before such issue will result in a major problem for those applying the standard. However, changes to full IFRS should not automatically trigger changes to the IFRS for SMEs. The amendments, including the costs and benefits related to these, should be assessed from the perspective of SMEs and the users of financial statements of SMEs. This means that an amendment made to full IFRS should first:

- represent a solution to an identified and documented problem for SMEs and thus result in improved financial reporting and/or
- prove useful for entities applying full IFRS before being considered for the IFRS for SMEs.

In addition, the amendments made to full IFRS may have to be modified to make them appropriate for SMEs.

These criteria mean that IFRS for SME's would not be changed based on changes in full IFRS that have not yet been implemented. The IASB should wait until the new standards have been implemented for a period so there is practical experience with their use and a post implementation review has been carried out. EFRAG considers it important that larger entities should be the first to apply the new treatment so that their experience can inform the roll-out to smaller entities.

Many of the questions raised in the RFI deal with whether more accounting policy options should be allowed in the IFRS for SMEs.

EFRAG is generally against allowing accounting policy options in the IFRS for SMEs as this would reduce comparability amongst entities using IFRS for SMEs. EFRAG shares the view that is explained in paragraphs BC91 to BC92 of the Basis for Conclusions accompanying the IFRS for SMEs. In EFRAG's view the standard is intended for small entities that are just interested in knowing what to do, therefore simple accounting policies would seem to serve this objective. It follows that introducing options would increase the complexity of the standard, and this would generally increase costs related to the application of the standard for both the preparers, that have to make decisions about what option to use and the users that will have to examine the accounting practice chosen and to assess the effects of the chosen accounting practice.

On the other hand, EFRAG considers the applicability of the IFRS for SMEs by many entities, potentially operating in diverse economic environments, as an important issue. EFRAG acknowledges that although options affect comparability negatively, on some issues an option to apply more sophisticated requirements to better represent the economic reality, might be necessary for the adoption of the IFRS for SMEs by some jurisdictions and entities. Therefore, in such cases the negative effects could be outweighed by the increased adoption of the standard by diverse entities in different jurisdictions, which would enhance the overall comparability of financial statements of SMEs.

On this basis, EFRAG considers that it could be beneficial to include options to revalue property, plant and equipment, to capitalise development costs and to capitalise borrowing costs on qualifying assets.

In cases, where options are introduced, the IASB should, however, mark the option that would generally be less costly as the default accounting treatment in order to ensure that entities would not have to spend resources in finding the less costly alternative.

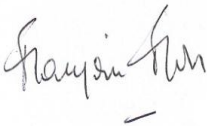
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EFRAG notes that its comments reflect that the various issues have been considered from a European perspective. In order to be able to consider the issues from a global perspective, information about the implementation issues that have arisen across the world and knowledge about these issues would be necessary.

Our detailed responses to the questions in the ED are set out in Appendix 1.

If you would like to discuss our comments further, please do not hesitate to contact Rasmus Sommer, Apostolena Theodosiou or me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Françoise Flores', with a short horizontal line underneath.

Françoise Flores

EFRAG Chairman

APPENDIX 1

EFRAG's responses to the questions raised in the *Comprehensive Review of the IFRS for SMEs*

Question S1 - Use by publicly traded entities (Section 1).

The IFRS for SMEs currently prohibits an entity whose debt or equity instruments are traded in a public market from using the IFRS for SMEs (paragraph 1.3(a)). The IASB concluded that all entities that choose to enter a public securities market become publicly accountable and, therefore, should use full IFRSs.

Some constituents believe that governments and regulatory authorities in each individual jurisdiction should decide whether some publicly traded entities should be eligible to use the IFRS for SMEs based on their assessment of the public interest, the needs of investors in their jurisdiction, and the capabilities of those publicly traded companies to implement full IFRSs.

Are the scope requirements of the IFRS for SMEs currently too restrictive for publicly traded entities?

- (a) No - do not change the current requirements. Continue to prohibit an entity whose debt or equity instruments trade in a public market from using the IFRS for SMEs.
- (b) Yes - revise the scope of the IFRS for SMEs to permit each jurisdiction to decide whether entities whose debt or equity instruments are traded in a public market should be permitted or required to use the IFRS for SMEs.
- (c) Other – please explain.

Please provide reasoning to support your choice (a), (b) or (c).

EFRAG's response

EFRAG thinks the IASB should explain why the IFRS for SMEs is not suitable for publicly traded entities (Alternative (c)).

- 1 Paragraph BC55 of the Basis for Conclusions accompanying the IFRS for SMEs states that ultimately, decisions on which entities should use the IFRS for SMEs will rest with national regulatory authorities and standard-setters.

"However, a clear definition of the class of entity for which the IFRS for SMEs is intended is essential so that:

- (a) the Board can decide on the standard that is appropriate for that class of entity, and
- (b) national regulatory authorities, standard-setters, reporting entities and their auditors will be informed of the intended scope of applicability of the IFRS for SMEs.

In that way, jurisdictions will understand that there are some types of entities for which the IFRS for SMEs is not intended."

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- 2 EFRAG agrees with paragraph BC55, but it considers that it would be more useful if jurisdictions were not only provided with the conclusion that the IFRS for SMEs is not intended for publicly accountable entities, but were provided with the rationale behind the IASB's assessment that the standard is not appropriate for those types of entities. (This view is further explained in paragraphs 4 to 8 below).
- 3 In cases where jurisdictions decide to allow or require entities, for which the IFRS for SMEs is not intended, to follow the standard, EFRAG would consider it beneficial for users to be made aware of this in the financial statements. (This view is further explained in paragraphs 9 to 10 below).

Rationale of the IASB's assessment

- 4 EFRAG agrees with paragraph BC45 of the Basis for Conclusions that users of financial statements of SMEs may have different information needs than users of financial statements prepared in accordance with full IFRS.
- 5 EFRAG had therefore hoped that the IASB, when preparing the IFRS for SMEs, would further analyse these differences. EFRAG is, however, not aware of such IASB research. Instead, EFRAG notes that paragraph D05 of the Basis for Conclusions informs that one IASB member does not believe that the IASB has demonstrated the need to make modifications to recognition and measurement requirements in IFRS for application by SMEs on the basis of either cost-benefit analysis or user needs.
- 6 Paragraphs BC98 to BC136 of the Basis for Conclusions accompanying the IFRS for SMEs explain the significant simplifications to the recognition and measurement principles in full IFRS. It seems as if most of the differences between the recognition and measurement principles in full IFRS and the IFRS for SMEs are caused by an attempt to make it less costly to prepare financial statements in accordance with the IFRS for SMEs. However, EFRAG considers that several of the IASB's assessments are not clear. It is, for example, not clear why the less costly methods are considered appropriate for non-publicly accountable entities and not for publicly accountable entities. EFRAG acknowledges that it may be proportionately more costly for a small entity to prepare financial statements applying complex requirements of full IFRS, but this does not explain the differentiation between publicly and non-publicly accountable entities.
- 7 In a few cases the different recognition and measurement requirements are justified by different users' needs. However, it is, for example, not clear why the IASB considers the equity method appropriate for users of full IFRS financial statements, when the method in relation to the IFRS for SMEs is considered ineffective for assessing future cash flows and loan security for lenders.
- 8 It is also not explained why various disclosure requirements are considered necessary for publicly accountable entities, but not for non-publicly accountable (based on both costs and benefits).

The IFRS for SMEs is applied by entities for which the standard has not been developed

- 9 EFRAG could see some merits in allowing entities for which the standard is not intended to claim compliance with the requirements of the IFRS for SMEs, if all the requirements of the standard are met. This could be effective when communicating the accounting policies applied. It could, for example, be relevant in cases where jurisdictions after having considered the IASB's arguments on why

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the standard is inappropriate for publicly accountable entities, decide to allow small listed entities to apply the standard.

- 10 In those cases, however, EFRAG considers that it would be beneficial for users of financial statements to be alerted. Accordingly, when the IFRS for SMEs has been applied by entities for which the standard is not intended, the IFRS for SMEs should require this to be disclosed. This would inform a user that the standard has been applied under circumstances that are different from the circumstances under which the user would normally find the standard applied and/or where the user would normally expect the financial statements to be prepared in accordance with full IFRS.

Question S2 - Use by financial institutions (Section 1)

The IFRS for SMEs currently prohibits financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses from using the IFRS for SMEs (paragraph 1.3(b)). The IASB concluded that standing ready to take and hold funds from a broad group of outsiders makes those entities publicly accountable and, therefore, they should use full IFRSs.

In every jurisdiction financial institutions are subject to regulation. In some jurisdictions, financial institutions such as credit unions and micro banks are very small. Some believe that governments and regulatory authorities in each individual jurisdiction should decide whether some financial institutions should be eligible to use the *IFRS for SMEs* on the basis of their assessment of the public interest, the needs of investors in their jurisdiction and the capabilities of those financial institutions to implement full IFRSs.

Are the scope requirements of the IFRS for SMEs currently too restrictive for financial institutions and similar entities?

- (a) No—do not change the current requirements. Continue to prohibit financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses from using the IFRS for SMEs.
- (b) Yes—revise the scope of the IFRS for SMEs to permit each jurisdiction to decide whether financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses should be permitted or required to use the IFRS for SMEs.
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

EFRAG's response

EFRAG thinks the IASB should explain why the IFRS for SMEs is not suitable for financial institutions (Alternative (c)).

Consistent with the answer provided to Question S1, EFRAG thinks that the IASB should explain the rationale behind its assessment that the IFRS for SMEs is not appropriate for financial institutions. In addition, EFRAG considers it beneficial for users to be made aware of situations where the IFRS for SMEs is applied by entities for which the standard has not been developed.

Question S3 - Clarification of use by not-for-profit entities (Section 1)

The *IFRS for SMEs* is silent on whether not-for-profit (NFP) entities (eg charities) are eligible to use the *IFRS for SMEs*. Some interested parties have asked whether soliciting and accepting contributions would automatically make an NFP entity publicly accountable. The *IFRS for SMEs* specifically identifies only two types of entities that have public accountability and, therefore, are not eligible to use the *IFRS for SMEs*:

- those that have issued debt or equity securities in public capital markets; and
- those that hold assets for a broad group of outsiders as one of their primary businesses.

Should the *IFRS for SMEs* be revised to clarify whether an NFP entity is eligible to use it?

- (a) Yes—clarify that soliciting and accepting contributions does not automatically make an NFP entity publicly accountable. An NFP entity can use the IFRS for SMEs if it otherwise qualifies under Section 1.
- (b) Yes—clarify that soliciting and accepting contributions will automatically make an NFP entity publicly accountable. As a consequence, an NFP entity cannot use the IFRS for SMEs.
- (c) No—do not revise the IFRS for SMEs for this issue.
- (d) Other—please explain.

(Please provide reasoning to support your choice of (a), (b), (c) or (d))

EFRAG's response

EFRAG agrees with Alternative (c), not to revise IFRS for SMEs.

- 11 EFRAG thinks that in many cases a not-for-profit entity would not be publicly accountable as it would neither have its debt or equity instruments traded in a public market, nor hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. EFRAG does not see why the fact that an entity is not-for-profit is relevant for being publicly accountable. The statutes of the not-for-profit entity determine whether such an entity is publicly accountable or not. EFRAG considers the standard to be sufficiently clear on this issue and does not see a need to revise the IFRS for SMEs.
- 12 Moreover, the IFRS Constitution is limited to financial reporting by private sector companies. In the Constitution review of 2008 the question of developing financial reporting standards for not-for-profit entities was addressed, but not accommodated. This would, in our view, be another compelling reason not to revise the IFRS for SMEs in this respect.

Question S4 - Consideration of recent changes to the consolidation guidance in full IFRSs (Section 9)

The *IFRS for SMEs* establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. This is consistent with the current approach in full IFRSs.

Recently, full IFRSs on this topic have been updated by IFRS 10 *Consolidated Financial Statements*, which replaced IAS 27 *Consolidated and Separate Financial Statements* (2008). IFRS 10 includes additional, stricter guidance on applying the control principle in a number of situations, with the intention of avoiding divergence in practice. The guidance will generally affect borderline cases where it is difficult to establish if an entity has control (ie, most straightforward parent-subsidiary relationships will not be affected). Additional guidance is provided under IFRS 10 for:

- agency relationships, where one entity legally appoints another to act on its behalf. This guidance is particularly relevant to investment managers that make decisions on behalf of investors. Fund managers and entities that hold assets for a broad group of outsiders as a primary business are generally outside the scope of the IFRS for SMEs.
- control with less than a majority of the voting rights, sometimes called 'de facto control' (this principle is already addressed in paragraph 9.5 of the IFRS for SMEs but in less detail than in IFRS 10).
- assessing control where potential voting rights exist, such as options, rights or conversion features that, if exercised, give the holder additional voting rights (this principle is already addressed in paragraph 9.6 of the IFRS for SMEs but in less detail than in IFRS 10).

The changes above will generally mean that more judgement needs to be applied in borderline cases and where more complex relationships exist.

Should the changes outlined above be considered, but modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?

- (a) No—do not change the current requirements. Continue to use the current definition of control and the guidance on its application in Section 9. They are appropriate for SMEs, and SMEs have been able to implement the definition and guidance without problems.
- (b) Yes—revise the IFRS for SMEs to reflect the main changes from IFRS 10 outlined above (modified as appropriate for SMEs).
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c)).

EFRAG's response

EFRAG does not think the main changes from IFRS 10 should be incorporated into the IFRS for SMEs now, but perhaps in the future (Alternative (c)).

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- 13 As mentioned in the cover letter, EFRAG thinks that the objective of the IFRS for SMEs should not be to provide a regime for non-publicly accountable subsidiaries of listed parent companies with fewer disclosure requirements, but with similar recognition and measurement guidance, as under full IFRS. EFRAG thinks that the IASB should consider developing such a regime outside the IFRS for SMEs.
- 14 EFRAG understands that the changes to the consolidation requirements, resulting in IFRS 10, were triggered by issues that arose in larger and complex organisations.
- 15 In addition, EFRAG notes that the changes were considered controversial when introduced in IFRS 10 and currently it has not been possible to test whether the changed requirements work in practice for entities applying full IFRS.
- 16 EFRAG is, therefore, uncertain about the effects and benefits of introducing the requirements for SMEs.
- 17 EFRAG believes that a situation where SMEs will have to spend resources on implementing changes that may result in only few or no benefits and even potentially result in unintended consequences should be avoided.
- 18 EFRAG therefore assesses that more evidence is needed if the changes outlined in Question S4, modified as appropriately for SMEs, should be reflected in the IFRS for SMEs. This evidence should, as earlier explained, demonstrate that the suggested changes:
 - (a) would be a solution to an identified and documented problem for SMEs and thus result in improved financial reporting and/or
 - (b) have proven to be useful for entities applying full IFRS.
- 19 This means that if the IFRS for SMEs should be changed, a post-implementation review of IFRS 10 should first have been performed.

Question S5 - Use of recognition and measurement provisions in full IFRSs for financial instruments (Section 11)

The *IFRS for SMEs* currently permits entities to choose to apply either (paragraph 11.2):

- the provisions of both Sections 11 and 12 in full, or
- the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement and the disclosure requirements of Sections 11 and 12.

In paragraph BC106 of the Basis for Conclusions issued with the *IFRS for SMEs*, the IASB lists its reasons for providing SMEs with the option to use IAS 39. This is the only time that the *IFRS for SMEs* specifically permits the use of full IFRSs. One of the main reasons for this option is that the IASB concluded that SMEs should be permitted to have the same accounting policy options as in IAS 39, pending completion of its comprehensive financial instruments project to replace IAS 39. That decision is explained in more detail in paragraph BC106.

IAS 39 will be replaced by IFRS 9 *Financial Instruments*. Any amendments to the *IFRS for SMEs* from this comprehensive review would most probably be effective at a similar time to the effective date of IFRS 9. The *IFRS for SMEs* refers specifically to IAS 39. SMEs are not permitted to apply IFRS 9.

How should the current option to use IAS 39 in the *IFRS for SMEs* be updated once IFRS 9 has become effective?

- (a) There should be no option to use the recognition and measurement provisions in either IAS 39 or IFRS 9. All SMEs must follow the financial instrument requirements in Sections 11 and 12 in full.
- (b) Allow entities the option of following the recognition and measurement provisions of IFRS 9 (with the disclosure requirements of Sections 11 and 12).
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c)).

Note: the purpose of this question is to assess your overall view on whether the fallback to full IFRSs in Sections 11 and 12 should be removed completely, should continue to refer to an IFRS that has been superseded, or should be updated to refer to a current IFRS. It does not ask respondents to consider whether any of the recognition and measurement principles of IFRS 9 should result in amendments of the *IFRS for SMEs* at this stage, because the IASB has several current agenda projects that are expected to result in changes to IFRS 9 (see paragraph 13 of the Introduction to this Request for Information).

EFRAG's response

EFRAG agrees with Alternative (b). It thinks that entities should be given the option of following the recognition and measurement provisions of IFRS 9 when this standard is completed. However, post-implementation reviews should consider whether the option could be removed.

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- 20 EFRAG thinks that the IFRS for SMEs should be updated to give entities the option of following the recognition and measurement provisions of IFRS 9 (with the disclosure requirements of Sections 11 and 12), when IFRS 9 is completed.
- 21 EFRAG believes that it would not make much sense to keep the reference to IAS 39, when this standard is replaced by IFRS 9.
- 22 EFRAG has considered whether the option to depart from the recognition and measurement requirements of Sections 11 and 12 of the IFRS for SMEs should be removed. In this regard it has been noted that IFRS 9 is, to some extent, based on the IFRS for SMEs. Removing the option may therefore have limited effects. However, before considering removing the option, a post-implementation review should be performed. This review should provide evidence on the extent to which the option is used in practice by SMEs.

Question S6 - Guidance on fair value measurement for financial and non-financial items (Section 11 and other sections)

Paragraphs 11.27–11.32 of the IFRS for SMEs contain guidance on fair value measurement. Those paragraphs are written in the context of financial instruments. However, several other sections of the *IFRS for SMEs* make reference to them, for example, fair value model for associates and jointly controlled entities (Sections 14 and 15), investment property (Section 16) and fair value of pension plan assets (Section 28). In addition, several other sections refer to fair value although they do not specifically refer to the guidance in Section 11. There is some other guidance about fair value elsewhere in the *IFRS for SMEs*, for example, guidance on fair value less costs to sell in paragraph 27.14.

Recently the guidance on fair value in full IFRSs has been consolidated and comprehensively updated by IFRS 13 *Fair Value Measurement*. Some of the main changes are:

- a. an emphasis that fair value is a market-based measurement (not an entity-specific measurement);
- b. an amendment to the definition of fair value to focus on an exit price (fair value is defined in IFRS 13 as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”); and
- c. more specific guidance on determining fair value, including assessing the highest and best use of non-financial assets and identifying the principal market.

The guidance on fair value in Section 11 is based on the guidance on fair value in IAS 39. The IAS 39 guidance on fair value has been replaced by IFRS 13.

In straightforward cases, applying the IFRS 13 guidance on fair value would have no impact on the way fair value measurements are made under the *IFRS for SMEs*. However, if the new guidance was to be incorporated into the *IFRS for SMEs*, SMEs would need to re-evaluate their methods for determining fair value amounts to confirm that this is the case (particularly for non-financial assets) and use greater judgement in assessing what data market participants would use when pricing an asset or liability.

Should the fair value guidance in Section 11 be expanded to reflect the principles in IFRS 13, modified as appropriate to reflect the needs of users of SME financial statements and the specific circumstance of SMEs (for example, it would take into account their often more limited access to markets, valuation expertise, and other cost-benefit considerations)?

- (a) No—do not change the current requirements. The guidance for fair value measurement in paragraphs 11.27–11.32 is sufficient for financial and non-financial items.
- (b) Yes—the guidance for fair value measurement in Section 11 is not sufficient. Revise the IFRS for SMEs to incorporate those aspects of the fair value guidance in IFRS 13 that are important for SMEs, modified as appropriate for SMEs (including the appropriate disclosures).
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

Note: an alternative is to create a separate section in the *IFRS for SMEs* to deal with guidance on fair value that would be applicable to the entire *IFRS for SMEs*, rather than leaving such guidance in Section 11. This is covered in the following question (question S7).

EFRAG's response

EFRAG does not think the principles from IFRS 13 should be incorporated into the IFRS for SMEs now, but perhaps in the future (Alternative (c)).

- 23 EFRAG thinks that a situation should be avoided where SMEs will have to spend resources on implementing changes that may result in only few or no benefits.
- 24 When providing its endorsement advice on IFRS 13, EFRAG experienced that the standard was difficult to understand and it could therefore be complicated and costly to apply without further educational efforts initiated by the IASB. At the same time, EFRAG notes that it is stated in Question S6 that “in straightforward cases, applying the IFRS 13 guidance on fair value would have no impact on the way fair value measurements are made under the IFRS for SMEs.”
- 25 EFRAG therefore assesses that more evidence is needed if the principles outlined in Question S6, modified as appropriately for SMEs, should be reflected in the IFRS for SMEs. This evidence should, as explained earlier, demonstrate that the suggested changes:
 - (a) would be a solution to an identified and documented problem for SMEs and thus result in improved financial reporting and/or
 - (b) have proven to be useful for entities applying full IFRS.
- 26 This means that if the IFRS for SMEs should be changed, a post-implementation review of IFRS 13 should first have been performed.

Question S7 - Positioning of fair value guidance in the Standard (Section 11)

As noted in question S6, several sections of the *IFRS for SMEs* (covering both financial and non-financial items) make reference to the fair value guidance in Section 11.

Should the guidance be moved into a separate section? The benefit would be to make clear that the guidance is applicable to all references to fair value in the *IFRS for SMEs*, not just financial instruments.

- (a) No—do not move the guidance. It is sufficient to have the fair value measurement guidance in Section 11.
- (b) Yes—move the guidance from Section 11 into a separate section on fair value measurement.
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

Please answer this question regardless of your answer to question S6.

EFRAG's response

EFRAG agrees with Alternative (b), that the fair value guidance should be moved into a separate section.

- 27 EFRAG notes that fair value guidance may also be relevant in other cases than for financial instruments. This is, for example, the case when accounting for investments in subsidiaries, associates, jointly controlled entities, business combinations, leases, share-based payment, investment properties, biological assets, and when performing an impairment test.
- 28 EFRAG therefore thinks the standard could be more user friendly if the guidance on fair value measurement is placed in a separate section.

Question S8 - Consideration of recent changes to accounting for joint ventures in full IFRSs (Section 15)

Recently, the requirements for joint ventures in full IFRSs have been updated by the issue of IFRS 11 *Joint Arrangements*, which replaced IAS 31 *Interests in Joint Ventures*. A key change resulting from IFRS 11 is to classify and account for a joint arrangement on the basis of the parties' rights and obligations under the arrangement. Previously under IAS 31, the structure of the arrangement was the main determinant of the accounting (ie establishment of a corporation, partnership or other entity was required to account for the arrangement as a jointly-controlled entity). In line with this, IFRS 11 changes the definitions and terminology and classifies arrangements as either joint operations or joint ventures.

Section 15 is based on IAS 31 except that Section 15 (like IFRS 11) does not permit proportionate consolidation for joint ventures, which had been permitted by IAS 31. Like IAS 31, Section 15 classifies arrangements as jointly controlled operations, jointly controlled assets or jointly controlled entities. If the changes under IFRS 11 described above were adopted in Section 15, in most cases, jointly controlled assets and jointly controlled operations would become joint operations and jointly controlled entities would become joint ventures. Consequently, there would be no change to the way they are accounted for under Section 15.

However, it is possible that, as a result of the changes, an investment that previously met the definition of a jointly controlled entity would become a joint operation. This is because the existence of a separate legal vehicle is no longer the main factor in classification.

Should the above changes to full IFRSs be reflected in the *IFRS for SMEs*, modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?

- (a) No—do not change the current requirements. Continue to classify arrangements as jointly controlled assets, jointly controlled operations and jointly controlled entities (terminology and classification based on IAS 31 *Interests in Joint Ventures*). The existing Section 15 is appropriate for SMEs, and SMEs have been able to implement it without problems.
- (b) Yes—revise the IFRS for SMEs so that arrangements are classified as joint ventures or joint operations on the basis of the parties' rights and obligations under the arrangement (terminology and classification based on IFRS 11 *Joint Arrangements*, modified as appropriate for SMEs).
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

Note: this would not change the accounting options available for jointly-controlled entities meeting the criteria to be joint ventures (ie cost model, equity method and fair value model).

EFRAG's response

EFRAG does not think the main changes from IFRS 11 should be incorporated into the IFRS for SMEs now, but perhaps in the future (Alternative (c)).

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- 29 EFRAG thinks that a situation should be avoided where SMEs will have to spend resources on implementing changes that may result in only few or no benefits.
- 30 EFRAG therefore assesses that more evidence is needed if the changes outlined in Question S8, modified as appropriately for SMEs, should be reflected in the IFRS for SMEs. This evidence should, as explained earlier, demonstrate that the suggested changes:
- (a) would be a solution to an identified and documented problem for SMEs, and thus result in improved financial reporting and/or
 - (b) have proven to be useful for entities applying full IFRS.
- 31 This means that if the IFRS for SMEs should be changed, a post-implementation review of IFRS 11 should first have been performed.

Question S9 - Revaluation of property, plant and equipment (Section 17)

The IFRS for SMEs currently prohibits the revaluation of property, plant and equipment (PPE). Instead, all items of PPE must be measured at cost less any accumulated depreciation and any accumulated impairment losses (cost-depreciation-impairment model—paragraph 17.15). Revaluation of PPE was one of the complex accounting policy options in full IFRSs that the IASB eliminated in the interest of comparability and simplification of the *IFRS for SMEs*.

In full IFRSs, IAS 16 *Property, Plant and Equipment* allows entities to choose a revaluation model, rather than the cost-depreciation-impairment model, for entire classes of PPE. In accordance with the revaluation model in IAS 16, after recognition as an asset, an item of PPE whose fair value can be measured reliably is carried at a revalued amount—its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluation increases are recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus (unless an increase reverses a previous revaluation decrease recognised in profit or loss for the same asset). Revaluation decreases that are in excess of prior increases are recognised in profit or loss. Revaluations must be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

Should an option to use the revaluation model for PPE be added to the *IFRS for SMEs*?

- (a) No—do not change the current requirements. Continue to require the cost-depreciation-impairment model with no option to revalue items of PPE.
- (b) Yes—revise the IFRS for SMEs to permit an entity to choose, for each major class of PPE, whether to apply the cost-depreciation-impairment model or the revaluation model (the approach in IAS 16).
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

EFRAG's response

EFRAG agrees with Alternative (b). EFRAG is supportive of introducing an option to revalue property plant and equipment but suggests that the cost-depreciation-impairment model is marked as the most simple, less costly option and thus the default accounting treatment.

- 32 While EFRAG is generally against the introduction of options, as set out in the cover letter, as this would reduce comparability amongst entities using the IFRS for SMEs, increases complexity and is costly, it acknowledges that allowing some specific options, like the revaluation of property plant and equipment, would be beneficial to the adoption of IFRS for SMEs in certain jurisdictions.
- 33 EFRAG considers the applicability of the IFRS for SMEs by many entities, potentially operating in diverse economic environments, as an important issue. Although options affect comparability negatively, on some issues an option to apply more sophisticated requirements that are considered to better represent the economic reality, might be considered necessary for the adoption or application of the IFRS for SMEs by some jurisdictions and entities.

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- 34 EFRAG shares the view that it could therefore be beneficial for the IFRS for SMEs to include an option to revalue property plant and equipment. It would not be logical to deprive entities applying IFRS for SMEs from the possibility to revalue their property, as in some countries SMEs may need to present the revalued amount of their property in the balance sheet in order to obtain loan financing or to meet other requirements. Moreover, in some jurisdictions, revaluation of PPE is compulsory and SMEs in these countries could not apply IFRS for SMEs if the revaluation option is not introduced.
- 35 On balance, EFRAG believes that the negative effects of introducing the option to revalue property plant and equipment could be outweighed by the increased adoption of the standard by diverse entities in different jurisdictions, which would enhance the overall comparability of financial statements of SMEs. Therefore, EFRAG is supportive of introducing such option, but suggests that the cost-depreciation-impairment model is marked as the most simple and less costly option and thus as the default accounting treatment.

Question S10 - Capitalisation of development costs (Section 18)

The IFRS for SMEs currently requires that all research and development costs be charged to expense when incurred unless they form part of the cost of another asset that meets the recognition criteria in the *IFRS for SMEs* (paragraph 18.14). The IASB reached that decision because many preparers and auditors of SME financial statements said that SMEs do not have the resources to assess whether a project is commercially viable on an ongoing basis. Bank lending officers told the IASB that information about capitalised development costs is of little benefit to them, and that they disregard those costs in making lending decisions.

In full IFRSs, IAS 38 *Intangible Assets* requires that all research and some development costs be charged to expense, but development costs incurred after the entity is able to demonstrate that the development has produced an asset with future economic benefits should be capitalised. IAS 38.57 lists certain criteria that must be met for this to be the case*.

Should the IFRS for SMEs be changed to require capitalisation of development costs meeting criteria for capitalisation (based on the criteria in IAS 38)?

- (a) No—do not change the current requirements. Continue to charge all development costs to expense.
- (b) Yes—revise the IFRS for SMEs to require capitalisation of development costs meeting the criteria for capitalisation (the approach in IAS 38).
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

*IAS 38.57 states: "An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

- (a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.
- (b) its intention to complete the intangible asset and use or sell it.
- (c) its ability to use or sell the intangible asset.
- (d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
- (e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.

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

EFRAG's response

EFRAG agrees with Alternative (c). EFRAG is supportive of introducing an option to allow an entity to either capitalise or expense development costs but suggests that the expensing of development costs is marked as the most simple, less costly option and thus the default accounting treatment.

- 36 While EFRAG is generally against the introduction of options, as set out in the cover letter, as this would reduce comparability amongst entities using the IFRS for SMEs, increases complexity and is costly, it acknowledges that allowing some specific options, like the capitalisation of development costs, would be beneficial for the adoption of IFRS for SMEs in certain jurisdictions (see our response to S9).
- 37 EFRAG shares the view that it could be beneficial for the IFRS for SMEs to include an option to capitalise development costs. Development costs could be significant for some smaller companies and expensing them may accordingly not result in a

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fair presentation of the performance of these entities. EFRAG considered it logical that SMEs would be allowed for an option that is considered appropriate as a requirement for publicly accountable entities. EFRAG noted that many European jurisdictions include options in their national accounting regulation. In this regard members also noted that having the same options under the IFRS for SMEs as under local GAAP would facilitate the transition to the IFRS for SMEs.

- 38 EFRAG does not think that it would be cost-efficient to introduce a requirement to capitalise development costs in the IFRS for SMEs. It would be costly for entities to capitalise development costs as it would, for example, require distinction between research and development. A less costly alternative to a requirement to capitalise development costs would be to make it optional to capitalise these costs.
- 39 On balance, EFRAG believes that the negative effects of introducing the option to either capitalise or expense development costs could be outweighed by the increased adoption of the standard by diverse entities in different jurisdictions, which would enhance the overall comparability of financial statements of SMEs. Therefore, EFRAG is supportive of introducing the option to either capitalise or expense development costs, but suggests that the expensing of development costs is marked as the most simple and less costly option and thus the default accounting treatment.

Question S11 - Amortisation period for goodwill and other intangible assets (Section 18)

Paragraph 18.21 requires an entity to amortise an intangible asset on a systematic basis over its useful life. This requirement applies to goodwill as well as other intangible assets (see paragraph 19.23(a)). Paragraph 18.20 states “If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be ten years.” Some interested parties have said that, in some cases, although the management of the entity is unable to estimate the useful life reliably, management’s judgement is that the useful life is considerably shorter than ten years.

Should paragraph 18.20 be modified to state: “If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be ten years unless a shorter period can be justified”?

- (a) No—do not change the current requirements. Retain the presumption of ten years if an entity is unable to make a reliable estimate of the useful life of an intangible asset (including goodwill).
- (b) Yes—modify paragraph 18.20 to establish a presumption of ten years that can be overridden if a shorter period can be justified.
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

EFRAG’s response

EFRAG thinks that paragraph 18.20 should be amended to establish that a presumption of ten years can be overridden if a shorter period can be justified, but if an entity is unable to make a reliable estimate, the life shall be presumed to be not more than ten years (Alternative (b)/(c)).

- 40 EFRAG thinks that paragraph 18.20 of the IFRS for SMEs should be amended in order to introduce the suggested more flexible approach on how to determine the useful life of intangible assets (and particularly goodwill). EFRAG does not consider that the current presumption that the useful life of an intangible asset is ten years will result in the most useful information, when there are indications that it will be less. It therefore supports that the presumption of ten years can be overridden.
- 41 EFRAG, however, believes that the wording suggested in the RFI (“if the entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be ten years unless a shorter period can be justified”) may result in confusion. EFRAG therefore suggests that the standard instead would specify that if the entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be not more than ten years.

Question S12 - Consideration of changes to accounting for business combinations under full IFRSs (Section 19)

The IFRS for SMEs accounts for all business combinations by applying the purchase method. This is similar to the 'acquisition method' approach currently applied in full IFRSs.

Section 19 of the IFRS for SMEs is generally based on the 2004 version of IFRS 3 *Business Combinations*. IFRS 3 was revised in 2008, which was near the time of the release of the *IFRS for SMEs*. IFRS 3 (2008) addressed deficiencies in the previous version of IFRS 3 without changing the basic accounting; it also promoted international convergence of accounting standards.

The main changes introduced by IFRS 3 (2008) that could be considered for incorporation in the IFRS for SMEs are:

- A focus on what is given as consideration to the seller, rather than what is spent in order to acquire the entity. As a consequence, acquisition-related costs are recognised as an expense rather than treated as part of the business combination (for example, advisory, valuation and other professional and administrative fees).
- Contingent consideration is recognised at fair value (without regard to probability) and then subsequently accounted for as a financial instrument instead of as an adjustment to the cost of the business combination.
- Determining goodwill requires remeasurement to fair value of any existing interest in the acquired company and measurement of any non-controlling interest in the acquired company.

Should Section 19 be amended to incorporate the above changes, modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?

- (a) No—do not change the current requirements. The current approach in Section 19 (based on IFRS 3 (2004)) is suitable for SMEs, and SMEs have been able to implement it without problems.
- (b) Yes—revise the IFRS for SMEs to incorporate the main changes introduced by IFRS 3 (2008), as outlined above and modified as appropriate for SMEs.
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

EFRAG's response

EFRAG does not think the main changes from IFRS 3 (2008) should be incorporated into the IFRS for SMEs now, but perhaps in the future (Alternative (c)).

- 42 EFRAG thinks that a situation should be avoided where SMEs will have to spend resources on implementing changes that may result in only few or no benefits.
- 43 EFRAG therefore assesses that more evidence is needed if the changes outlined in Question S12, modified as appropriately for SMEs, should be reflected in the

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IFRS for SMEs. This evidence should, as explained earlier, demonstrate that the suggested changes:

- (a) would be a solution to an identified and documented problem for SMEs and thus result in improved financial reporting for SMEs and/or
- (b) have proven to be useful for entities applying full IFRS.

44 This means that if the IFRS for SMEs should be changed, the already announced post-implementation review of IFRS 3 should first be finalised.

Question S13 - Presentation of share subscriptions receivable (Section 22)

Paragraph 22.7(a) requires that subscriptions receivable, and similar receivables that arise when equity instruments are issued before the entity receives the cash for those instruments, must be offset against equity in the statement of financial position, not presented as an asset.

Some interested parties have told the IASB that their national laws regard the equity as having been issued and require the presentation of the related receivable as an asset.

Should paragraph 22.7(a) be amended to either permit or require the presentation of the receivable as an asset?

- (a) No—do not change the current requirements. Continue to present the subscription receivable as an offset to equity.
- (b) Yes—change paragraph 22.7(a) to require that the subscription receivable is presented as an asset.
- (c) Yes—add an additional option to paragraph 22.7(a) to permit the subscription receivable to be presented as an asset, ie the entity would have a choice whether to present it as an asset or as an offset to equity.
- (d) Other—please explain.

(Please provide reasoning to support your choice of (a), (b), (c) or (d))

EFRAG's response

EFRAG thinks that the subscription receivable should be presented as an asset when certain criteria are met (Alternative (d)).

- 45 It is EFRAG's view that subscriptions receivable and similar receivables that arise when equity instruments are issued before the entity receives the cash for those instruments are receivables and should be presented as such in the balance sheet (no offsetting) when:
- (a) the equity instruments provide the holder with the same rights as equity instruments that have been fully paid, and
 - (b) the entity has an enforceable right to the consideration to be received in exchange for the equity instruments.
- 46 In other situations, EFRAG does not think the equity instruments and the receivable should be presented (gross).

Question S14 - Capitalisation of borrowing costs on qualifying assets (Section 25)

The *IFRS for SMEs* currently requires all borrowing costs to be recognised as an expense when incurred (paragraph 25.2). The IASB decided not to require capitalisation of any borrowing costs for cost-benefit reasons, particularly because of the complexity of identifying qualifying assets and calculating the amount of borrowing costs eligible for capitalisation.

IAS 23 *Borrowing Costs* requires that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (ie an asset that necessarily takes a substantial period of time to get ready for use or sale) must be capitalised as part of the cost of that asset, and all other borrowing costs must be recognised as an expense when incurred.

Should Section 25 of the *IFRS for SMEs* be changed so that SMEs are required to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, with all other borrowing costs recognised as an expense when incurred?

- (a) No—do not change the current requirements. Continue to require all borrowing costs to be recognised as an expense when incurred.
- (b) Yes—revise the *IFRS for SMEs* to require capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (the approach in IAS 23).
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

EFRAG's response

EFRAG agrees with Alternative (c). EFRAG is supportive of introducing an option to allow an entity to either capitalise or expense borrowing costs on qualifying assets but suggests that the expensing of borrowing costs is marked up as the most simple, less costly option and thus the default accounting treatment.

- 47 While EFRAG is generally against the introduction of options, as set out in the cover letter, as this would reduce comparability amongst entities using the *IFRS for SMEs*, increases complexity and is costly, it acknowledges that allowing some specific options, like the capitalisation of borrowing costs, would be beneficial for the adoption of *IFRS for SMEs* in certain jurisdictions.
- 48 For the reasons mentioned in the response to S10 above, EFRAG does not think that a general requirement to capitalise borrowing costs on qualifying assets should be introduced in the *IFRS for SMEs*.
- 49 However, EFRAG acknowledges that in certain circumstances it might be cost-benefit efficient for entities to capitalise borrowing costs.
- 50 Therefore, EFRAG is supportive of introducing an option to allow an entity to either capitalise or expense borrowing costs on qualifying assets for similar reasons as mentioned in the response to S10 above and suggests that the expensing of borrowing costs is marked as the most simple and less costly option and thus as the default treatment.

Question S15 - Presentation of actuarial gains or losses (Section 28)

In accordance with the IFRS for SMEs, an entity is required to recognise all actuarial gains and losses in the period in which they occur, either in profit or loss or in other comprehensive income as an accounting policy election (paragraph 28.24).

Recently, the requirements in full IFRSs have been updated by the issue of IAS 19 *Employee Benefits* (revised 2011). A key change as a result of the 2011 revisions to IAS 19 is that all actuarial gains and losses must be recognised in other comprehensive income in the period in which they arise. Previously, under full IFRSs, actuarial gains and losses could be recognised either in other comprehensive income or in profit or loss as an accounting policy election (and under the latter option there were a number of permitted methods for the timing of the recognition in profit or loss).

Section 28 is based on IAS 19 before the 2011 revisions, modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations. Removing the option for SMEs to recognise actuarial gains and losses in profit or loss would improve comparability between SMEs without adding any complexity.

Should the option to recognise actuarial gains and losses in profit or loss be removed from paragraph 28.24?

- (a) No—do not change the current requirements. Continue to allow an entity to recognise actuarial gains and losses either in profit or loss or in other comprehensive income as an accounting policy election.
- (b) Yes—revise the IFRS for SMEs so that an entity is required to recognise all actuarial gains and losses in other comprehensive income (ie removal of profit or loss option in paragraph 28.24).
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

Note: IAS 19 (revised 2011) made a number of other changes to full IFRSs. However, because Section 28 was simplified from the previous version of IAS 19 to reflect the needs of users of SME financial statements and cost-benefit considerations, the changes made to full IFRSs do not directly relate to the requirements in Section 28.

EFRAG's response

EFRAG thinks that the profit or loss option should be removed (Alternative (b)).

- 51 EFRAG generally thinks that options make the IFRS for SMEs relatively more costly for both preparers and users. Options increase costs for preparers as these will have to make decisions about what options to choose. Options also results in financial statements being less comparable and users will have to examine the accounting practice chosen by an entity and assess the effects of the chosen accounting policies. In this particular case it also notes that the option is not necessary in order to provide SMEs with the same options as entities applying full IFRS.
- 52 EFRAG would therefore welcome a revision of the IFRS for SMEs so that an entity is required to recognise all actuarial gains and losses in other comprehensive income (i.e. removal of profit or loss option in paragraph 28.24).

Question S16 - Approach for accounting for deferred income taxes (Section 29)

Section 29 of the *IFRS for SMEs* currently requires that deferred income taxes must be recognised using the temporary difference method. This is also the fundamental approach required by full IFRSs (*IAS 12 Income Taxes*).

Some hold the view that SMEs should recognise deferred income taxes and that the temporary difference method is appropriate. Others hold the view that while SMEs should recognise deferred income taxes, the temporary difference method (which bases deferred taxes on differences between the tax basis of an asset or liability and its carrying amount) is too complex. They propose replacing the temporary difference method with the timing difference method (which bases deferred taxes on differences between when an item of income or expense is recognised for tax purposes and when it is recognised in profit or loss). Others hold the view that SMEs should recognise deferred taxes only for timing differences that are expected to reverse in the near future (sometimes called the 'liability method'). And still others hold the view that SMEs should not recognise any deferred taxes at all (sometimes called the 'taxes payable method').

Should SMEs recognise deferred income taxes and if so, how should they be recognised?

- (a) Yes—SMEs should recognise deferred income taxes using the temporary difference method (the approach currently used in both the IFRS for SMEs and full IFRSs).
- (b) Yes—SMEs should recognise deferred income taxes using the timing difference method.
- (c) Yes—SMEs should recognise deferred income taxes using the liability method.
- (d) No—SMEs should not recognise deferred income taxes at all (ie they should use the taxes payable method), although some related disclosures should be required.
- (e) Other—please explain.

(Please provide reasoning to support your choice of (a), (b), (c), (d) or (e))

EFRAG's response

EFRAG thinks that for the moment, SMEs should recognise deferred income taxes using the temporary difference method. However, a different method could be chosen in the future (Alternative (e)).

53 EFRAG believes that the IFRS for SMEs should only be amended when a need for a change has been demonstrated among those entities for which the standard is intended. EFRAG notes that there seems to be divergent views on how costly it is for SMEs to account for deferred income tax under the current requirements. EFRAG would therefore encourage the IASB to explore this further.

54 However, until the results of such a study are ready, and a more appropriate treatment of income taxes has been decided, SMEs should recognise deferred income taxes using the temporary difference method.

- 55 When it comes to finding a more appropriate treatment of income taxes, EFRAG notes that its pro-active work in relation to reporting on income taxes performed in co-operation with the FRC and supported by fourteen National Standard Setters in Europe (the discussion paper *Improving the Financial Reporting of Income Tax* and the following outreach events) has demonstrated that this could be difficult.

Question S17 - Consideration of IAS 12 exemptions from recognising deferred taxes and other differences under IAS 12 (Section 29)

In answering this question, please assume that SMEs will continue to recognise deferred income taxes using the temporary difference method (see discussion in question S16).

Section 29 is based on the IASB's March 2009 exposure draft *Income Tax*. At the time the *IFRS for SMEs* was issued, that exposure draft was expected to amend IAS 12 *Income Taxes* by eliminating some exemptions from recognising deferred taxes and simplifying the accounting in other areas. The IASB eliminated the exemptions when developing Section 29 and made the other changes in the interest of simplifying the *IFRS for SMEs*.

Some interested parties, familiar with IAS 12, say that Section 29 does not noticeably simplify IAS 12 and that the removal of the IAS 12 exemptions results in more deferred tax calculations being required. Because the March 2009 exposure draft was not finalised, some question whether the differences between Section 29 and IAS 12 are now justified.

Should Section 29 be revised to conform it to IAS 12, modified as appropriate to reflect the needs of the users of SME financial statements?

- (a) No—do not change the overall approach in Section 29.
- (b) Yes—revise Section 29 to conform it to the current IAS 12 (modified as appropriate for SMEs).
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

EFRAG's response

EFRAG agrees with Alternative (b).

- 56 EFRAG thinks that the IFRS for SMEs by eliminating some exemptions from recognising deferred taxes and simplifying the accounting in other areas has introduced more complexity into the area of deferred tax than exists with the current IAS 12. EFRAG notes that it is mentioned in the RFI that “some interested parties, familiar with IAS 12, say that Section 29 does not noticeably simplify IAS 12 and that the removal of the IAS 12 exemptions results in more deferred tax calculations being required”. In addition, EFRAG notes that some experience exists in relation to calculating deferred tax in accordance with IAS 12, and it is more difficult to transfer this knowledge to SMEs when the requirements under the IFRS for SMEs are not similar to the requirements of IAS 12. EFRAG therefore thinks it will be helpful for both users and preparers to revise Section 29 to conform it to the current IAS 12 (modified as appropriate for SMEs).
- 57 EFRAG also wants to signal that this case illustrates that amendments to the IFRS for SMEs should not be based on exposure drafts related to full IFRS. Only when the IASB's due process have resulted in final standards or amendments to full IFRS could these changes be considered for the IFRS for SMEs.

Question S18 - Rebuttable presumption that investment property at fair value is recovered through sale (Section 29)

In answering this question, please also assume that SMEs will continue to recognise deferred income taxes using the temporary difference method (see discussion in question S16).

In December 2010, the IASB amended IAS 12 to introduce a rebuttable presumption that the carrying amount of investment property measured at fair value will be recovered entirely through sale.

The amendment to IAS 12 was issued because, without specific plans for the disposal of the investment property, it can be difficult and subjective to estimate how much of the carrying amount of the investment property will be recovered through cash flows from rental income and how much of it will be recovered through cash flows from selling the asset.

Paragraph 29.20 currently states:

“The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover or settle the carrying amount of the related assets and liabilities”.

Should Section 29 be revised to incorporate a similar exemption from paragraph 29.20 for investment property at fair value?

- (a) No—do not change the current requirements. Do not add an exemption in paragraph 29.20 for investment property measured at fair value.
- (b) Yes—revise Section 29 to incorporate the exemption for investment property at fair value (the approach in IAS 12).
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

Note: please answer this question regardless of your answer to question S17 above.

EFRAG's response

EFRAG does not think the main changes from IFRS 3 (2008) should be incorporated into the IFRS for SMEs now, but perhaps in the future (Alternative (c)).

- 58 EFRAG thinks that a situation should be avoided where SMEs will have to spend resources on implementing changes that may result in only few or no benefits.
- 59 EFRAG therefore assesses that more evidence is needed if the exemptions outlined in Question S18 should be reflected in the IFRS for SMEs. This evidence should, as explained earlier, demonstrate that the suggested changes:
 - (a) would be a solution to an identified and documented problem for SMEs and thus result in improved financial reporting for SMEs and/or
 - (b) have proven to be useful for entities applying full IFRS.

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- 60 In the particular case, EFRAG notes that if entities applying full IFRS have had difficulties with estimating how the carrying amount of investment properties will be recovered, SMEs will likely face the same problem. However, before amending the IFRS for SMEs by including a rebuttable presumption about the recovery of investment property, it should be assessed whether the amendment made to full IFRS has solved the problem for entities applying full IFRS without resulting in any unintended consequences.

Question S19 - Inclusion of additional topics in the IFRS for SMEs

The IASB intended that the 35 sections in the *IFRS for SMEs* would cover the kinds of transactions, events and conditions that are typically encountered by most SMEs. The IASB also provided guidance on how an entity's management should exercise judgement in developing an accounting policy in cases where the *IFRS for SMEs* does not specifically address a topic (see paragraphs 10.4–10.6).

Are there any topics that are not specifically addressed in the *IFRS for SMEs* that you think should be covered (ie where the general guidance in paragraphs 10.4–10.6 is not sufficient)?

- (a) No.
- (b) Yes (please state the topic and reasoning for your response).

Note: this question is asking about topics that are not currently addressed by the *IFRS for SMEs*. It is not asking which areas of the *IFRS for SMEs* require additional guidance. If you think more guidance should be added for a topic already covered by the *IFRS for SMEs*, please provide your comments in response to question S20.

EFRAG's response

EFRAG is not aware of any additional topics that should be addressed in the IFRS for SMEs.

- 61 EFRAG is not aware of any additional topics that should be addressed in the IFRS for SMEs. In this regard, EFRAG would, however, like to emphasise the importance of post-implementation reviews. These reviews can identify additional topics that should be addressed.

Question S20 - Opportunity to add your own specific issues

Are there any additional issues that you would like to bring to the IASB's attention on specific requirements in the sections of the IFRS for SMEs?

- (a) No.
- (b) Yes (please state your issues clearly, identify the section(s) to which they relate, provide references to paragraphs in the IFRS for SMEs where applicable and provide separate reasoning for each issue given).

EFRAG's response

EFRAG thinks that the IASB should consider some of the issues that have been brought forward by EFRAG's constituents.

62 In their comment letters to EFRAG (and the IASB) many constituents, included issues they thought should be considered by the IASB. From these comment letters, EFRAG would like to support the following issues:

- (a) It is necessary to develop review criteria and guidance on when changes to full IFRS should be considered. In relation to the current RFI it is, for example, unclear why modifications of the Framework for full IFRS and amendments to IAS 1 have not been considered in relation to the specific questions.
- (b) The IFRS for SMEs does not permit hedge accounting with an option-based hedging strategy. According to paragraph BC104 of the basis for conclusion the reason is that hedging with options involves incurring a cost. It is therefore assumed by the IASB that SMEs are more likely to use forward contracts as hedging instruments than options. According to one of EFRAG's constituents, options are, however, used for hedging quite frequently in practice.
- (c) Some of the simplifications in IFRS 3 concerning the allocation of the cost of a business combination to the identifiable assets and liabilities, especially defined benefit obligations and deferred taxes, are equally necessary for SMEs (paragraph 19.14). Without this, SMEs are obliged to determine 'pure' fair value instead of being able to benefit from the simplifications which allow certain measures to be treated as fair values.
- (d) In many cases, recognising all intangible assets of the acquiree in a business combination (according to paragraph 18.8) is complex.
- (e) The IFRS for SMEs should state explicitly that an entity shall not prepare its financial statements on a going concern basis if the going concern assumption is no longer appropriate because of events that occurred after the balance sheet date.
- (f) Paragraph 9.16 should state that a parent can use the financial statements of a subsidiary if the balance sheet date of the subsidiary is not more than three months before or after the balance sheet date of the parent entity.
- (g) The requirement in paragraph 22.8 to measure equity instruments at the fair value of the cash or other resources received would prohibit business combinations under common control applying the pooling of interest method.

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EFRAG consider that this is not the intention as business combinations under common control are scoped out of Section 19 – Business Combinations and Goodwill.

Question G1 - Consideration of minor improvements to full IFRSs

The IFRS for SMEs was developed from full IFRSs but tailored for SMEs. As a result, the *IFRS for SMEs* uses identical wording to full IFRSs in many places.

The IASB makes ongoing changes to full IFRSs as part of its Annual Improvements project as well as during other projects. Such amendments may clarify guidance and wording, modify definitions or make other relatively minor amendments to full IFRSs that address unintended consequences, conflicts or oversights. For more information, the IASB web pages on its Annual Improvements project can be accessed on the following link:

<http://www.ifrs.org/Current+Projects/IASB+Projects/Annual+Improvements/Annual+Improvements+Process.htm>.

Some believe that because those changes are intended to improve requirements, they should naturally be incorporated in the IFRS for SMEs where they are relevant.

Others note that each small change to the IFRS for SMEs would unnecessarily increase the reporting burden for SMEs because SMEs would have to assess whether each individual change will affect its current accounting policies. Those who hold that view concluded that, although the *IFRS for SMEs* was based on full IFRSs, it is now a separate Standard and does not need to reflect relatively minor changes in full IFRSs.

How should the IASB deal with such minor improvements, where the IFRS for SMEs is based on old wording from full IFRSs?

- (h) Where changes are intended to improve requirements in full IFRSs and there are similar wordings and requirements in the IFRS for SMEs, they should be incorporated in the (three-yearly) omnibus exposure draft of changes to the IFRS for SMEs.
- (i) Changes should only be made where there is a known problem for SMEs, ie there should be a rebuttable presumption that changes should not be incorporated in the IFRS for SMEs.
- (j) The IASB should develop criteria for assessing how any such improvements should be incorporated (please give your suggestions for the criteria to be used).
- (k) Other—please explain.

(Please provide reasoning to support your choice of (a), (b), (c) or (d))

EFRAG's response

EFRAG thinks that minor improvements to full IFRS should only be reflected in the IFRS for SMEs when the improvements would be a solution to an identified and documented problem for SMEs and have proven to be useful for entities applying full IFRS (Alternative (c)).

63 EFRAG thinks that a situation should be avoided where SMEs will have to spend resources on implementing changes that may result in only few or no benefits.

64 EFRAG therefore assesses that more evidence is needed before minor improvements to full IFRS could be included in the IFRS for SMEs. This evidence should, as explained earlier, demonstrate that the suggested changes:

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- (a) would be a solution to an identified and documented problem for SMEs and thus result in improved financial reporting for SMEs and/or
- (b) have proven to be useful for entities applying full IFRS.

65 In addition, unless a minor improvement is considered urgent, minor improvements should only be incorporated into the IFRS for SMEs on a triennial basis.

Question G2 - Further need for Q&As

One of the key responsibilities of the SMEIG has been to consider implementation questions raised by users of the *IFRS for SMEs* and to develop proposed non-mandatory guidance in the form of questions and answers (Q&As). These Q&As are intended to help those who use the *IFRS for SMEs* to think about specific accounting questions.

The SMEIG Q&A programme has been limited. Only seven final Q&A have been published. Three of those seven deal with eligibility to use the *IFRS for SMEs*. No additional Q&As are currently under development by the SMEIG.

Some people are of the view that, while the Q&A programme was useful when the *IFRS for SMEs* was first issued so that implementation questions arising in the early years of application around the world could be dealt with, it is no longer needed. Any new issues that arise in the future can be addressed in other ways, for example through education material or future three-yearly updates to the IFRS for SMEs. Many who hold this view think that an ongoing programme of issuing Q&As is inconsistent with the principle-based approach in the *IFRS for SMEs*, is burdensome because Q&As are perceived to add another set of rules on top of the *IFRS for SMEs*, and has the potential to create unnecessary conflict with full IFRSs if issues overlap with issues in full IFRSs.

Others, however, believe that the volume of Q&As issued so far is not excessive and that the non-mandatory guidance is helpful, and not a burden, especially to smaller organisations and in smaller jurisdictions that have limited resources to assist their constituents in implementing the *IFRS for SMEs*. Furthermore, in general, the Q&As released so far provide guidance on considerations when applying judgement, rather than create rules.

Do you believe that the current, limited programme for developing Q&As should continue after this comprehensive review is completed?

- (a) Yes—the current Q&A programme should be continued.
- (b) No—the current Q&A programme has served its purpose and should not be continued.
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

EFRAG's response

EFRAG considers that it could be necessary to issue additional guidance; however, the procedure should be different from that currently applied (Alternative (c)).

66 EFRAG acknowledges that between reviews of the IFRS for SMEs, issues could arise that would benefit from further guidance. EFRAG would therefore be in favour of having something similar to the IFRS Interpretation Committee for the IFRS for SMEs.

67 However, EFRAG has not been in favour of the procedure applied when issuing Q&As so far since EFRAG believes that the criteria set for the development of Q&As in the SMEIG's terms of reference were often not respected.

68 In its comment letters in response to the Q&As issued, EFRAG has expressed concerns that the focus was not limited to a number of pervasive issues, as

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specified as an expectation in the SMEIG's terms of reference and operating procedures. EFRAG has been concerned that although the Q&As were issued as non-mandatory guidance, they are likely not perceived as such because they have been issued by the IFRS Foundation. This means that entities will have to study the Q&As in addition to the standard itself before applying the IFRS for SMEs. Accordingly, if the focus was not on a limited number of pervasive issues, this could result in many more pages of literature that SMEs would have to familiarise themselves with – and this would mean that the benefits of issuing a simple standard for SMEs would disappear. To solve the problem EFRAG recommended that the IFRS Foundation's SME Implementation Group developed criteria for when a Q&A should be issued. This could limit the number of issues being addressed through Q&As.

Question G3 - Treatment of existing Q&As

As noted in question G2, there are seven final Q&As for the IFRS for SMEs. This comprehensive review provides an opportunity for the guidance in those Q&As to be incorporated into the IFRS for SMEs and for the Q&As to be deleted.

Non-mandatory guidance from the Q&As will become mandatory if it is included as requirements in the IFRS for SMEs. In addition, any guidance may need to be incorporated in the IFRS for SMEs in a reduced format or may even be omitted altogether (if the IASB deems that the guidance is no longer applicable after the Standard is updated or that the guidance is better suited for inclusion in training material). The IASB would also have to decide whether any parts of the guidance that are not incorporated into the IFRS for SMEs should be retained in some fashion, for example, as an addition to the Basis for Conclusions accompanying the IFRS for SMEs or as part of the training material on the IFRS for SMEs.

An alternative approach would be to continue to retain the Q&As separately where they remain relevant to the updated IFRS for SMEs. Under this approach there would be no need to reduce the guidance in the Q&As, but the guidance may need to be updated because of changes to the IFRS for SMEs resulting from the comprehensive review.

Should the Q&As be incorporated into the IFRS for SMEs?

- (a) Yes—the seven final Q&As should be incorporated as explained above, and deleted.
- (b) No—the seven final Q&As should be retained as separate guidance from the IFRS for SMEs.
- (c) Other—please explain.

(Please provide reasoning to support your choice of (a), (b) or (c))

EFRAG's response

EFRAG considers that the seven final Q&As should be incorporated into the IFRS for SMEs or the training material depending on the detail of the guidance (Alternative (c)).

- 69 EFRAG has concerns about incorporating non-mandatory guidance that is sometimes very detailed into the IFRS for SMEs, but at the same time it does not consider it useful to keep the seven final Q&As as separate guidance.
- 70 EFRAG therefore suggests that the Q&As are only incorporated into the standard itself to the extent that clarification on a principle level is achieved. More detailed guidance could, on the other hand, be included in the training material only. An analysis needs to be made for each of the seven Q&As, so that the principles based character of IFRS for SMEs is not undermined by including too many details that would not fit the overall level and balance of the standard. Where the Q&A is too detailed or too narrow in its focus, inclusion in the training material could be appropriate.

Question G4 - Training material

The IFRS Foundation has developed comprehensive free-to-download self-study training material to support the implementation of the *IFRS for SMEs*. These are available on our website: <http://www.ifrs.org/IFRS+for+SMEs/Training+material.htm>. In addition to your views on the questions we have raised about the *IFRS for SMEs*, we welcome any comments you may have about the training material, including any suggestions you may have on how we can improve it.

Do you have any comments on the IFRS Foundation's *IFRS for SMEs* training material available on the link above?

- (a) No.
- (b) Yes (please provide your comments).

EFRAG's response

EFRAG has been informed that the training material is of high quality.

- 71 The people that EFRAG has consulted on the training material have all noted that they think it is of high quality.

Question G5 - Opportunity to add any further general issues

Are there any additional issues you would like to bring to the IASB's attention relating to the IFRS for SMEs?

- (a) No.
- (b) Yes (please state your issues clearly and provide separate reasoning for each issue given).

EFRAG's response

EFRAG believes that the criteria for amending the IFRS for SMEs should be established and included in a formal document.

- 72 EFRAG believes that it could be useful to include criteria for amending the IFRS for SMEs in a formal document. As previously mentioned, we think that the IFRS for SMEs should only be changed when the change addresses an identified problem and the change is likely to solve that problem and thus results in improved financial reporting. Unless a change is considered particularly urgent, the change should only be incorporated into the IFRS for SMEs as part of the triennial review.
- 73 This means that an amendment made to full IFRS should not be incorporated into the IFRS for SMEs unless the amendment:
- (a) would be a solution to an identified and documented problem for SMEs and thus results in improved financial reporting for SMEs and/or
 - (b) has proven useful for entities applying full IFRS before being considered for the IFRS for SMEs.

Question G6 – Use of IFRS for SMEs in your jurisdiction

This question contains four sub-questions. The purpose of the questions is to give us some information about the use of the IFRS for SMEs in the jurisdictions of those responding to this Request for Information.

- 2 What is your country/jurisdiction?
- 3 Is the IFRS for SMEs currently used in your country/jurisdiction?
 - (a) Yes, widely used by a majority of our SMEs.
 - (b) Yes, used by some but not a majority of our SMEs.
 - (c) No, not widely used by our SMEs.
 - (d) Other (please explain).
- 4 If the IFRS for SMEs is used in your country/jurisdiction, in your judgement what have been the principal benefits of the IFRS for SMEs?

(Please give details of any benefits.)
- 5 If the IFRS for SMEs is used in your country/jurisdiction, in your judgement what have been the principal practical problems in implementing the IFRS for SMEs?

(Please give details of any problems.)

EFRAG's response

Based on the input EFRAG has received, the IFRS for SMEs is only applied to a very limited extent within the EU.

- 74 Within the EU, the IFRS for SMEs cannot be applied by entities as an alternative to national requirements. In addition, Member States cannot allow the use of the IFRS for SMEs when it is not in accordance with the European Accounting Directives.
- 75 Based on the input EFRAG has received, the IFRS for SMEs is only applied to a very limited extent within the EU.