

Feedback Statement

EFRAG's consultation on

Compatibility Analysis: IFRS for SMEs and the EU Accounting Directives

Background and purpose of this feedback statement

- 1 In November 2009, the European Commission asked EFRAG to provide it with advice detailing on exactly which points the IFRS for SMEs (International Financial Reporting Standard for Small and Medium-sized Entities) is incompatible with the EU Accounting Directives (78/660/EC and 83/349/EEC).
- 2 In May 2010 EFRAG issued its advice to the European Commission. In this letter the following requirements of IFRS for SMEs were considered incompatible with the EU Accounting Directives:
 - (a) The prohibition to present or describe any items of income and expense as 'extraordinary items' in the statement of comprehensive income (or in the income statement, if presented) or in the notes (IFRS for SMEs par. 5.10).
 - (b) The requirement to measure financial instruments within the scope of section 12 of the IFRS for SMEs (non-basic financial instruments) at fair value (IFRS for SMEs par. 12.7 and 12.8).
 - (c) The requirement to presume the useful life of goodwill to be ten years if an entity is unable to make a reliable estimate of the useful life (IFRS for SMEs par. 19.23).
 - (d) The requirement to recognise immediately in profit or loss any negative goodwill (IFRS for SMEs par. 19.24).
 - (e) The requirement to present the amount receivable from equity instruments, issued before the entity receives the cash or other resources, as an offset to equity and not as an asset (IFRS for SMEs par. 22.7(a)).
 - (f) The prohibition to reverse an impairment loss recognised for goodwill (IFRS for SMEs par. 27.28).
- 3 The scope and limitations of EFRAG's advice were explained in EFRAG's letter to the European Commission.
- 4 Before issuing its advice to the European Commission, EFRAG issued a draft letter for comment. In addition to the requirements mentioned in paragraph 2, the

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following requirements of IFRS for SMEs were considered incompatible with the EU Accounting Directives in the draft letter:

- (a) The requirement to measure associates for which there were a published price quotation using the fair value model (IFRS for SMEs par. 14.7 and 14.10).
- (b) The requirement to measure investments in jointly controlled entities for which there were a published price quotation using the fair value model (IFRS for SMEs par. 15.12 and 15.15).

5 The draft letter also mentioned that a minority of EFRAG members thought:

- (a) The requirement of paragraph 9.6 of the IFRS for SMEs was incompatible with the EU Accounting Directives. Paragraph 9.6 of the IFRS for SMEs required an entity to consider options and convertible instruments when assessing whether an entity controlled another entity.
- (b) That either:
 - (i) the requirements in paragraphs 19.14 and 29.24, requiring recognition of contingent liabilities acquired in a business combination and measurement of deferred tax assets and deferred tax liabilities using the probability-weighted average amount to reflect uncertainties about whether tax authorities would accept the amounts reported to them; or
 - (ii) the requirement in paragraph 21.4 prohibiting recognition of provisions unless it is probable that the entity would be required to transfer economic benefits in settlement

were incompatible with the EU Accounting Directives.

6 In its draft letter, EFRAG asked its constituents to list other requirements of the IFRS for SMEs that would be incompatible with the EU Accounting Directives. Individual constituents identified 16 specific requirements of the IFRS for SMEs they thought could or would be incompatible with the EU Accounting Directives.

7 One of these requirements – the requirement to present the amount receivable from equity instruments, issued before the entity receives the consideration, as an offset to equity - was also considered by EFRAG as incompatible with the EU Accounting Directives and included in its list of incompatible requirements.

8 The remaining 15 specific requirements were not included in EFRAG's list of requirements of IFRS for SMEs that were considered incompatible with the EU Accounting Directives.

9 In response to its draft letter, EFRAG also received comments in relation to the limitations of EFRAG's advice. Some of these comments were considered in EFRAG's final drafting of the letter including the list of identified incompatible requirements. Others were not. Among the comments that were not incorporated into EFRAG's letter of identified incompatible requirements were two issues related to how EFRAG has carried out its analysis. The issues were related to how 'incompatibility' was defined and the assumption that IAS at 1 May 2002 were compatible with the EU Accounting Directives.

- 10 The purpose of this feedback statement is to provide EFRAG's rationale for:
- (a) not including the requirements of the IFRS for SMEs mentioned in paragraphs 4 and 5 and the additional 15 requirements mentioned by constituents in response so EFRAG's draft letter in its list of incompatible requirements; and
 - (b) not incorporating comments in relation to the two issues mentioned in paragraph 9.

EFRAG's reasons for not considering issues mentioned in EFRAG's draft comment letter to be incompatible with the EU Accounting Directives

The requirement to measure jointly controlled entities and associates for which there is a published price quotation using the fair value model

- 11 In its draft advice letter, EFRAG mentioned that it considered the requirements to measure associates and jointly controlled entities for which there were published price quotations using the fair value model to be incompatible with the EU Accounting Directives. These requirements were not listed in EFRAG's final letter to the European Commission.

- 12 The reason was that although BC 117 of IFRS for SMEs read:

The IFRS for SMEs requires that any investment in an associate or jointly controlled entity for which there is a published price quotation must be measured at fair value through profit or loss. The Board's reasons for reaching this decision were (a) concerns about measurement reliability are substantially eliminated, (b) the cost of obtaining a fair valuation is substantially eliminated and (c) such fair values are more relevant than cost-based measurements to lenders and other users of SMEs' financial statements.

the IFRS for SMEs allowed entities to measure investments in jointly controlled entities and associates using either:

- (a) a cost model;
 - (b) the equity method; or
 - (c) a fair value model.
- 13 The IFRS for SMEs – as the standard was worded - only required measurement at fair value if the cost model or the fair value model was applied. Measurement at fair value would be incompatible with the EU Accounting Directives. However, application of the equity method was assessed not to be incompatible with the EU Accounting Directives. Accordingly, as one of the options to measure investments in jointly controlled entities and associates was not incompatible with the EU Accounting Directives, the requirements of IFRS for SMEs regarding measurement of jointly controlled entities and associates were not considered to be incompatible with the EU Accounting Directives.

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The requirement to recognise contingent liabilities acquired in a business combination.

- 14 The requirement to recognise contingent liabilities acquired in a business combination was considered in EFRAG's draft advice to the European Commission. The majority of EFRAG members did not think the requirement was incompatible with the EU Accounting Directives, while a minority of members did.
- 15 From comment letters received in response to the draft letter and from discussions, EFRAG noted that at least two groups existed in relation to how to interpret Article 20.1 of the Fourth EU Accounting Directive. Article 20.1 of the Fourth EU Accounting Directive stated:
- Provisions are intended to cover liabilities the nature of which is clearly defined and which at the date of the balance sheet are either likely to be incurred, or certain to be incurred but uncertain as to amount or as to the date on which they will arise.
- 16 Some interpreted the article as:
- (a) allowing only liabilities where it was probable (ie more likely than not) that the entity would be required to transfer economic benefits in settlement to be recognised; or
 - (b) requiring all liabilities – even those where the probability that the entity would be required to transfer economic benefits was very low – to be recognised.
- 17 These members noted that article 31.1 (c) (bb) stated:
- account must be taken of all liabilities arising in the course of the financial year concerned or of a previous one, even if such liabilities become apparent only between the date of the balance sheet and the date on which it is drawn up
- 18 They therefore thought that if contingent liabilities were liabilities, they should all be recognised. If contingent liabilities were not liabilities, they should never be recognised.
- 19 Accordingly, either the requirement of the IFRS for SMEs to recognise contingent liabilities acquired in a business combination or the prohibition to recognise other contingent liabilities was incompatible with the EU Accounting Directives.
- 20 Others did not think article 20.1 dealt with recognition or measurement, but rather to where types of items were to be presented in the prescribed formats. Also, they thought that article 31.1 (c) (bb) did not deal with measurement. Accordingly, they thought it would not be incompatible with the EU Accounting Directives to measure contingent liabilities at nil in some cases and at fair value in other cases (when they were acquired in a business combination).
- 21 Accordingly, the paragraph would not prohibit different rules for contingent liabilities acquired in a business combination and those that were not.
- 22 Because of the different interpretations of the EU Accounting Directives on this matter, EFRAG decided that it could not state that it would be incompatible with the EU Accounting Directives to require contingent liabilities acquired in a business combination to be recognised in the balance sheet while prohibiting other contingent liabilities from being recognised.

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The requirement to recognise current tax and deferred tax using the probability-weighted average method

- 23 The requirement of the IFRS for SMEs to recognise current tax and deferred tax using the probability-weighted average method was considered in EFRAG's draft advice to the European Commission. Measuring deferred tax assets and liabilities using the probability-weighted average amount to reflect uncertainty about whether the tax authorities would accept the amounts reported by the entity could result in the recognition of liabilities where it was not probable that the entity would be required to transfer economic benefits.
- 24 For the same reasons as stated in paragraphs 16 and 18, some thought this was incompatible with the EU Accounting Directives. However, for the same reasons as stated in paragraph 18 others thought it was not incompatible with the EU Accounting Directives.
- 25 Because of the different interpretations of the EU Accounting Directives on this matter, EFRAG decided that it could not state that it would be incompatible with the EU Accounting Directives to require measurement of deferred tax liabilities using the probability-weighted average amount to reflect uncertainty about whether the tax authorities would accept the amounts reported by the entity.

The requirement to consider options and convertible instruments when assessing control

- 26 In its draft advice, EFRAG noted that a minority of EFRAG members thought that the requirement of the IFRS for SMEs to consider options and convertible instruments when assessing control was incompatible with the EU Accounting Directives.
- 27 However, the majority of EFRAG members either thought that:
- (a) the EU Accounting Directives were silent the issue and therefore did not prohibit entities to take options and convertible instruments into consideration when determining whether or not to consolidate an entity; or
 - (b) the fact that the EU Accounting Directives used the word 'right' (right to) in many places where control was discussed implied that also options and convertible instruments should be taken into consideration when assessing control.
- 28 Although some comment letters received in response to EFRAG's draft letter expressed uncertainty about the issue, none of the comment letters thought it was incompatible with the EU Accounting Directives to consider options and convertible instruments when assessing control. Accordingly, EFRAG decided that it could not state that this requirement was incompatible with the EU Accounting Directives.

EFRAG's reasons for not considering issues mentioned by constituents to be incompatible with the EU Accounting Directives

- 29 EFRAG received 14 comment letters in response to its draft letter to the European Commission. Some of these comment letters identified additional requirements that were or could be considered incompatible with the EU Accounting Directives. The following requirements were mentioned but not considered to be incompatible

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(as defined and limited for the purpose of this study) with the EU Accounting Directives by EFRAG:

- (a) The requirement to measure a tax asset acquired in a business combination at 100% or nil after initial recognition.
 - (b) The requirement to measure contingent liabilities acquired in a business combination at 100% or nil after initial recognition.
 - (c) The offsetting requirements of The IFRS for SMEs.
 - (d) The requirement to only depart from the requirement in the standard in extremely rare circumstances.
 - (e) The requirement to recognise as income distributions from jointly controlled entities and associates based on pre-acquisition profit.
 - (f) The prohibition to use the unitings of interests method.
 - (g) The option for an entity not to make prejudicial disclosures.
 - (h) The requirement to deduct excise duties etc. from revenue.
 - (i) The requirement to take future salary increases into consideration when measuring obligations under defined benefit plans.
 - (j) The option to measure defined benefit obligations using a simplified method.
 - (k) The requirement only to consider tax rates enacted by the reporting date.
 - (l) The prohibition to discount tax provisions.
 - (m) Considering presence on the shareholders meeting when assessing control of another entity.
 - (n) The requirements relating to 'other comprehensive income'.
 - (o) The requirement to discount liabilities.
- 30 EFRAG's reasons for not including these requirements on its list of incompatible requirements are provided in the following paragraphs.

The requirement to measure a tax asset acquired in a business combination at 100% or nil after initial recognition

- 31 One constituent thought that was incompatible with the EU Accounting Directives that IFRS for SMEs required an entity first to measure tax assets brought forward at "the real value paid" and afterwards to account for 100% or nil, when the tax asset was acquired in a business combination. The constituent did not think this provided a true and fair view.
- 32 EFRAG noted that contrary to (full) IFRS, the IFRS for SMEs did not include requirements to recognise and measure tax assets acquired in business combination in accordance with the requirements included in the section on income taxes on initial recognition. Instead the entity should recognise the

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acquiree's identifiable assets at their fair values if the criteria for recognising identifiable assets in a business combination were met.

- 33 In addition, EFRAG noted that the IFRS for SMEs after initial recognition would require an entity to measure a deferred tax asset (including a deferred tax asset for the carryforward of unused tax losses):
- (a) using the tax rates and laws that have been enacted or substantively enacted by the reporting date;
 - (b) reflecting 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;
 - (c) recognising a valuation allowance against deferred tax assets so that the net carrying amount equals the highest amount that is more likely than not to be recovered based on current or future taxable profit;
 - (d) reviewing the net carrying amount of a deferred tax asset at each reporting date and shall adjust the valuation allowance to reflect the current assessment of future taxable profits;
 - (e) not discounting the amount; and
 - (f) applying the probability-weighted average amount to account for uncertainty about whether the tax authorities will accept the amounts reported to them.
- 34 Due to for example the fact that an entity would not be allowed to discount the deferred tax asset on subsequent measurement, the subsequent measurement of deferred tax assets could be different from the initial measurement.
- 35 However,
- (a) as the IFRS for SMEs required departure from the IFRS for SMEs when compliance with the standard would be so misleading that it would conflict with the objectives of financial statements as stated in the IFRS for SMEs;
 - (b) as it was assessed that the requirement mentioned above in (a) was not incompatible with the EU Accounting Directives; and
 - (c) as it was assessed that if the requirements would not result in a true and fair view, they would also conflict with the objectives of financial statements as stated in the IFRS for SMEs

EFRAG did not think the requirement would be incompatible with the EU Accounting Directives.

The requirement to measure contingent liabilities acquired in a business combination at 100% or nil after initial recognition

- 36 One constituent thought it would be incompatible with the EU Accounting Directives that when contingent liabilities were assumed against a price, the company would not measure the contingent liability at its "real value" but at 100%

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or nil. The constituent noted that a lottery company would not make a provision for the prices that could be expected.

- 37 EFRAG noted that the IFRS for SMEs par. 21.7 stated:

An entity shall measure a provision at the best estimate of the amount required to settle the obligation at the reporting date. The best estimate is the amount an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time.

(a) When the provision involves a large population of items, the estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60 per cent or 90 per cent. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

(b) When the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation. However, even in such a case, the entity considers other possible outcomes. When other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.

When the effect of the time value of money is material, the amount of a provision shall be the present value of the amount expected to be required to settle the obligation. The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money. The risks specific to the liability should be reflected either in the discount rate or in the estimation of the amounts required to settle the obligation, but not both.

- 38 Accordingly, when a liability was recognised (for example when a contingent liability was recognised in a business combination and accordingly should be recognised as a provision) EFRAG noted that the price an entity rationally would pay to transfer the obligation to a third party would seem to reflect what the constituent termed “the real value”.
- 39 EFRAG acknowledged that if IFRS for SMEs could be read as stating that an entity assuming a contingent liability against a contribution outside a business combination should measure this contingent liability at nil, then IAS 37 at 1 May 2002 would have been read similarly. It was outside the scope of EFRAG’s study to assess requirements of IFRS for SMEs that were identical to those of IAS at 1 May 2002.
- 40 If the constituent thought that the requirements regarding contingent liabilities of IFRS for SMEs did not result in a true and fair view, the same argument as stated in paragraph 35 applied.

The offsetting requirements of the IFRS for SMEs

- 41 One constituent noted that the IFRS for SMEs included several examples where netting was prescribed without asking whether national legislation would create a net position: pension provision less plan assets; work in progress less instalments received; pension charges less employee contribution. The constituent did not think this was in accordance with the EU Accounting Directives
- 42 EFRAG acknowledged that par. 28.14 of the IFRS for SMEs stated:

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In applying the general recognition principle in paragraph 28.3 to defined benefit plans, an entity shall recognise:

(a) a liability for its obligations under defined benefit plans net of plan assets— its defined benefit liability (see paragraphs 28.15–28.23).

43 Also par. 28.28 of the IFRS for SMEs stated:

If an entity is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, the entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. In the statement of comprehensive income (or in the income statement, if presented), the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.

44 On the other hand the IFRS for SMEs did not include a requirement to measure work in progress net of installments received.

45 EFRAG noted that IAS 19 at 1 May 2002 included the following requirements

54. The amount recognised as a defined benefit liability should be the net total of the following amounts:

...

(d) minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 102-104).

....

66. The new IAS 19 requires explicitly that defined benefit obligations should be recognised as a liability after deducting plan assets (if any) out of which the obligations are to be settled directly (see paragraph 54 of the Standard). This is already widespread, and probably universal, practice. The Board believes that plan assets reduce (but do not extinguish) an enterprise's own obligation and result in a single, net, liability. Although the presentation of that net liability as a single amount in the balance sheet differs conceptually from the offsetting of separate assets and liabilities, the Board decided in issuing IAS 19 in 1998 that the definition of plan assets should be consistent with the offsetting criteria in IAS 32, Financial Instruments: Disclosure and Presentation. IAS 32 states that a financial asset and a financial liability should be offset and the net amount reported in the balance sheet when an enterprise:

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

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

....

91. Some post-employment health care plans require employees to contribute to the medical costs covered by the plan. Estimates of future medical costs take account of any such contributions, based on the terms of the plan at the balance sheet date (or based on any constructive obligation that goes beyond those terms). Changes in those employee contributions result in past service cost or, where applicable, curtailments. The cost of meeting claims may be reduced by benefits from state or other medical providers (see paragraphs 83(c) and 87).

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- 46 Accordingly, EFRAG assessed that in relation to pension plans, the requirement to deduct pension plan assets from a pension liability was also required in IAS 19 at 1 May 2002. Accordingly, this requirement was not within the scope of EFRAG's assessment. Also, the option in par. 28.28 of the IFRS for SMEs stating that "the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement" is only an option. Entities could therefore choose to present the amounts gross.
- 47 Based on the reasoning presented above, EFRAG concluded that the requirement to present pension obligations net of plan assets and the option to present expenses relating to a defined benefit plan net of reimbursements were not incompatible with the EU Accounting Directives.

The requirement to only depart from the requirement in the standard in extremely rare circumstances.

- 48 One constituent thought the requirement regarding when to depart from the requirements of the IFRS for SMEs were not compatible with the EU Accounting Directives.
- 49 According to the IFRS for SMEs par. 3.4:

In the extremely rare circumstances when management concludes that compliance with this IFRS would be so misleading that it would conflict with the **objective of financial statements** of SMEs set out in Section 2, the entity shall depart from that requirement in the manner set out in paragraph 3.5 unless the relevant regulatory framework prohibits such a departure.

- 50 According to the Fourth Accounting Directive article 2(5):

Where in exceptional cases the application of a provision of this Directive is incompatible with the obligation laid down in paragraph 3, that provision must be departed from in order to give a true and fair view within the meaning of paragraph 3. Any such departure must be disclosed in the notes on the accounts together with an explanation of the reasons for it and a statement of its effect on the assets, liabilities, financial position and profit or loss. The Member States may define the exceptional cases in question and lay down the relevant special rules.

- 51 It was argued that 'extremely rare circumstances' was not the same as 'exceptional cases' – at least not in practice.

EFRAG noted that IAS 1 at 1 May 2002 also used the expression 'extremely rare circumstances'. As EFRAG had previously decided not to challenge the conclusion made by the European Commission that IAS as of 1 May 2002 were compatible with the EU Accounting Directives, it was assessed that the requirement should not be assessed.

The requirement to recognise as income distributions from jointly controlled entities and associates based on pre-acquisition profit.

- 52 One constituent noted that it was not sure that par. 14.6 and 15.11 of the IFRS for SMEs were compatible with the EU Accounting Directives.
- 53 According to par. 14.6 of the IFRS for SMEs:

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The investor shall recognise dividends and other distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the associate arising before or after the date of acquisition.

- 54 According to par. 15.11 of the IFRS for SMEs:

The investor shall recognise distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the jointly controlled entity arising before or after the date of acquisition.

- 55 It thought that distribution of accumulated profits arisen before the acquisition date would only be realised in relation to the other shareholders. For the remaining part it was only a matter of transferring cash outside the associate or jointly controlled entity that was already in the associate or joint venture. It was thus argued that for a fully controlled subsidiary, distributing reserves existing before acquisition would be incompatible with the Fourth Accounting Directive, as this directive required that only realised income could be recognised.

- 56 However, the constituent also noted that paragraphs 14.6 and 15.11 of the IFRS for SMEs could be regarded as an option as par. 22.12 of the IFRS for SMEs stated:

A capitalisation or bonus issue (sometimes referred to as a stock dividend) is the issue of new shares to shareholders in proportion to their existing holdings. For example, an entity may give its shareholders one dividend or bonus share for every five shares held. A share split (sometimes referred to as a stock split) is the dividing of an entity's existing shares into multiple shares. For example, in a share split, each shareholder may receive one additional share for each share held. In some cases, the previously outstanding shares are cancelled and replaced by new shares. Capitalisation and bonus issues and share splits do not change total equity. An entity shall reclassify amounts within equity as required by applicable laws.

- 57 Accordingly, an associate or jointly controlled entity could first issue bonus shares, which according to par. 22.12 of IFRS would not be income, and later make capital repayment.

- 58 EFRAG noted that par. 14.6 and 15.11 of the IFRS for SMEs only related to jointly controlled entities and associates. Therefore, the requirements did not deal with how to recognise distribution received from a fully controlled subsidiary. EFRAG further assessed that distributions received from jointly controlled entities and associates could be regarded as realised, no matter whether the distributions were from accumulated profits of the jointly controlled entity or associate arising before or after the date of acquisition. On this basis EFRAG assessed that par. 14.6 and 15.11 of the IFRS for SMEs were not incompatible with the EU Accounting Directives.

The prohibition to use the unitings of interests method

- 59 One constituent thought that it was not compatible with the EU Accounting Directives that the IFRS for SMEs required the use of the acquisition method when a business combination was a pooling of interests. It thought it would not result in a 'true and fair view'.

- 60 EFRAG noted that the use of the uniting of interests method was a Member State option in the EU Accounting Directives and was thus not required. It therefore

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found it difficult to argue that the prohibition to use the uniting of interests method would not provide a 'true and fair view' according to the EU Accounting Directives. Also the arguments presented in paragraph 35 applied.

The option for an entity not to make prejudicial disclosures

61 One constituent thought that – at least in theory – par. 21.17 of the IFRS for SMEs was incompatible with the EU Accounting Directives.

62 According to the IFRS for SMEs par. 21.17:

In extremely rare cases, disclosure of some or all of the information required by paragraphs 21.14–21.16 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

63 The constituent noted that the EU Accounting Directives would not exempt an entity from presenting disclosures that could be expected to prejudice seriously the position of an entity in a dispute with other parties.

64 EFRAG noted that par. 21.17 of the IFRS for SMEs was only an option. Accordingly an entity could choose not to apply the option and still be able to prepare financial statements that would both comply with the EU Accounting Directives and the IFRS for SMEs. On this basis, EFRAG assessed that the IFRS for SMEs did not include any incompatible requirements in this area.

The requirement to deduct excise duties etc. from revenue

65 In line with the European Commission's interpretative communication (98/C 16/04), one constituent thought the requirement of the IFRS for SMEs to deduct excise duties etc. from revenue was incompatible with the EU Accounting Directives.

66 However, EFRAG noted that the requirement to deduct excise duties etc. from revenue was also included in IAS 18 at 1 May 2002. According, it was outside the scope of EFRAG's advice to assess the requirement.

The requirement to take future salary increases into consideration when measuring obligations under defined benefit plans

67 One constituent thought it was incompatible with the EU Accounting Directives that the IFRS for SMEs required that salary increases that were at the discretion of the company should be taken into account when measuring a defined benefit liability. The constituent did not think that obligations resulting from future salary increases had origin in the financial year or before. Also, it thought that including discretionary salary increases would impair the true and fair view.

68 EFRAG noted that also IAS 19 at 1 May 2002 required an entity to measure post-employment benefit obligations on a basis that reflected estimated future salary increases. According, it was outside the scope of EFRAG's advice to assess the requirement.

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The option to measure defined benefit obligations using a simplified method

- 69 One constituent thought that the simplified method allowed in the IFRS for SMEs regarding measurement of obligations and cost under a defined benefit plan was incompatible with the EU Accounting Directives.
- 70 EFRAG noted that the simplified method was an option. Accordingly, an entity could choose not to apply the option and still be able to prepare financial statements in accordance with the IFRS for SMEs. On this basis, EFRAG decided not to include the option in its list of incompatible requirements.

The requirement only to consider tax rates enacted by the reporting date

- 71 One constituent thought that the requirement of the IFRS for SMEs to only to consider tax rates enacted by the reporting date – and not tax rates enacted after the balance sheet date, before drawing up the accounts - when measuring current and deferred tax assets and liabilities.

- 72 EFRAG considered article 31 (c)(bb) of the Fourth Accounting Directive:

account must be taken of all liabilities arising in the course of the financial year concerned or of a previous one, even if such liabilities become apparent only between the date of the balance sheet and the date on which it is drawn up

- 73 EFRAG did not think the article – although not prohibiting - would require entities to consider changes in tax rates made after the balance sheet date. It thought that the article only required entities to recognise liabilities that existed on the balance sheet date and to measure recognised liabilities reflecting the situation as of the balance sheet date. Accordingly, EFRAG did not think it was incompatible with the EU Accounting Directives not to consider tax rates enacted after the balance sheet date but before the accounts would be drawn up.

The prohibition to discount tax provisions.

- 74 One constituent thought that the prohibition of the IFRS for SMEs to discount tax provisions would not provide a true and fair view.
- 75 EFRAG noted that also IAS 12 at May 2002 prohibited entities to discount current and deferred tax assets and liabilities. According, it was outside the scope of EFRAG's advice to assess the requirement.

Considering presence on the shareholders meeting when assessing control of another entity

- 76 One constituent thought that the IASB's opinion to consider the actual presence on the shareholders' meeting when assessing control was incompatible with the EU Accounting Directives.
- 77 EFRAG decided that it would not take IASB's opinion – but only the requirements stated in the IFRS for SMEs - into consideration when assessing what requirements of the IFRS for SMEs would be incompatible with the EU Accounting Directives. Accordingly, EFRAG decided not to include the issue in its assessment.

The requirements relating to ‘other comprehensive income’

- 78 One constituent noted that the concept of OCI was not defined in the EU Accounting Directives. It thought that a statement of comprehensive income could result in different results for the financial year under IFRS for SMEs and the EU Accounting Directives as this statement should “only present” the information required by the EU Accounting Directives for the preparation of the profit and loss account. Also, the constituent noted that EFRAG in its draft letter had chosen not to consider the requirements regarding recycling included in the IFRS for SMEs to be incompatible with the Directives as the Directives were silent on recycling. The constituent, however, thought it was important to take a position on the accounting treatment proposed by the IFRS for SMEs as the subject had potentially significant impact on the profit and loss.
- 79 EFRAG noted, that it, contrary to the constituent, did not read the EU Accounting Directives as prohibiting other information, than what was required for the profit and loss account, to be presented in a statement of comprehensive income. Article 10a of the Fourth Accounting Directive stated that the information provided in such a statement should “at least equivalent” that otherwise required to be presented in the profit and loss account.
- 80 Also, EFRAG noted that it had considered the items that could be recognised directly in other comprehensive income according to the EU Accounting Directives. It concluded initially that it was not in accordance with the EU Accounting Directives to recognise actuarial gains and losses on a pension liability in equity/OCI. However, a comprehensive analysis about the content etc. of comprehensive income statements prepared in accordance with the EU Accounting Directives was needed before EFRAG could provide an opinion on the issue. However, as it was only an option in the IFRS for SMEs to recognise actuarial gains and losses in equity, the issue was not listed as an incompatible requirement in EFRAG’s draft letter, as the alternative option – to recognise the actuarial gains and losses in profit or loss was not considered to be incompatible with the EU Accounting Directives.

The requirement to discount liabilities

- 81 One constituent thought that the requirement of the IFRS for SMEs to discount provisions when the time value of money was material could be incompatible with the EU Accounting Directives. The constituent thought that the issue required further analysis.
- 82 However, as a requirement to discount provisions when the time value of money was material was also included in IAS 37 at 1 May 2002, EFRAG decided that it it was outside the scope of EFRAG’s advice to assess the requirement.

EFRAG’s considerations in relation to definitions and assumptions

Definition of ‘incompatible’

- 83 In EFRAG’s assessment, if the IFRS for SMEs offered several options for the accounting treatment of a transaction or an event, the requirement of IFRS for SMEs was only considered incompatible with the EU Accounting Directives if all the options were incompatible with the Directives. Some constituents found this definition of ‘incompatible’ less useful. They thought that all options that were

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incompatible with the Directives should be listed to clarify the choice of options available to entities.

- 84 EFRAG noted that it had carried out its assessment based on and in accordance with a specific request from the European Commission. In that request it was specified that an incompatibility should be considered to mean an accounting treatment required by the IFRS for SMEs that was not permitted under the EU Accounting Directives.
- 85 During EFRAG's assessment, European Commission staff noted that it would find it useful if EFRAG could also note if it, during its assessment, found that any of the options included in the IFRS for SMEs would not be permitted under the EU Accounting Directives. Accordingly, when it was assessed whether or not an option under the IFRS for SMEs would not be permitted under the EU Accounting Directives, this was noted in EFRAG's working paper. This paper was also made available to the European Commission and on EFRAG's website and forms an integral part of EFRAG's advice.

Assumption that IAS at 1 May 2002 were compatible with the EU Accounting Directives

- 86 The Directive 2003/51/EC of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/349/EEC and 91/674/EEC stated in its preamble: "The amendments will remove all inconsistencies between Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the one hand and IAS in existence at 1 May 2002, on the other".
- 87 EFRAG discussed whether it should challenge this statement. It decided and agreed with European Commission staff, that it should not. Therefore, EFRAG did not assess requirements of IFRS for SMEs that were identical to requirements of IAS at 1 May 2002.
- 88 In response to EFRAG's draft letter, some constituents disagreed that IAS at 1 May 2002 were compatible with the EU Accounting Directives or noted that the conclusion stated in the preamble could only be considered in the specific context and for the purpose of the Directive of 18 June 2003.
- 89 EFRAG noted that it had not assessed whether or not requirements of IAS at 1 May 2002 were compatible with the EU Accounting Directives as it had been agreed with the European Commission to be outside the scope of the assessment.
- 90 In case the European Commission would decide to challenge its conclusion from 2003, EFRAG's working paper clearly stated in what cases EFRAG did not assess whether or not a requirement of IFRS for SMEs was compatible with the EU Accounting Directives because the requirement was identical to a requirement of IAS at 1 May 2002.