EFRAG
European Financial Reporting Advisory Group

DRAFT COMMENT LETTER
Comments should be submitted by 18 January 2012 to
Commentletter@efrag.org

Note to constituents

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 this will result in an outcome that is not in accordance with the European Accounting Directives.

XX MONTH 2012

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

Dear Sir/Madam,

On behalf of EFRAG, I am writing to comment on the draft Q&As:

- Fallback to IFRS 9 *Financial Instruments*;
- Recycling of cumulative exchange differences on disposal of a subsidiary.

The draft Q&A *Fallback to IFRS 9 Financial Instruments* considers whether an entity can apply the recognition and measurement provisions of IFRS 9. It is stated in the response that the IFRS for SMEs specifically allows an entity to apply the recognition and measurement criteria of IAS 39. As the standard does not allow entities to apply the recognition and measurement requirements of IFRS 9, entities are not permitted to apply the requirements of IFRS 9 instead of the requirements included in section 11 and 12 of the IFRS for SMEs.

The draft Q&A *Recycling of cumulative exchange differences on disposal of a subsidiary* includes a response to the question whether cumulative exchange differences that arise on translation into a presentation currency are prohibited from being recognised in profit or loss on disposal of the subsidiary. The paragraphs in the IFRS for SMEs dealing with translation to the presentation currency are silent on this issue. It is stated in the response that a paragraph in the section on consolidation and separate financial statements deals with the issue and prohibits recycling of the mentioned differences.

EFRAG agrees with the answer provided in the draft Q&A *Fallback to IFRS 9 Financial Instruments* and thinks the Q&A should be issued.

We also agree with the answer provided in the draft Q&A *Recycling of cumulative exchange differences on disposal of a subsidiary*. However, we do not think the Q&A should be issued. The IFRS for SMEs may not be sufficiently clear on the issue, but we think the solution would be to amend the IFRS for SMEs rather than issuing a Q&A. As we expect only few entities to be affected by the issue, and as these entities could find clear guidance on the issue in paragraph BC123 of the Basis for Conclusion, we also think the cost of issuing a Q&A to help entities in the period until the standard can be amended will outweigh the benefits.

Our detailed comments on the draft Q&As are set out in Appendix 1.

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

Yours sincerely,

Françoise Flores

EFRAG, Chairman

Appendix 1

Fallback to IFRS 9 *Financial Instruments*

Notes to EFRAG's constituents

1 *Paragraphs 11.2 and 12.2 in the sections on financial instruments in the IFRS for SMEs state than an entity shall choose to apply either:*

(a) *the provisions of both Section 11 and Section 12 in full, or*

(b) *the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurements and the disclosure requirements of Section 11 and 12*

to account for all of its financial instruments. An entity's choice of (a) or (b) is an accounting policy choice. Paragraphs 10.8 – 10.14 contain requirements for determining when a change in accounting policy is appropriate, how such a change should be accounted for, and what information should be disclosed about the change.

2 *The question raised in the Q&A is whether an entity may choose to apply the recognition and measurement provisions of IFRS 9 instead of IAS 39, as the IASB has been replacing IAS 39 with IFRS 9.*

3 *The answer provided in the Q&A is that as the IFRS for SMEs specifically refers to IAS 39, SMEs are not permitted to apply IFRS 9.*

View of EFRAG:

- EFRAG agrees with the answer provided in the draft Q&A.

4 EFRAG agrees with the answer provided in the draft Q&A. We agree that the standard specifically refers to IAS 39, but as IFRS 9 replaces IAS 39 in (full) IFRS, we think it is beneficial to specify whether an SME can apply IFRS 9 instead of IAS 39 in a Q&A.

5 In addition, we think the Q&A should specify the version of IAS 39 that should be applied by referring to the standard as issued at a specific date. We note that in some recent versions of the standard, requirements that relate to issues that are also dealt with in IFRS 9 are removed.

6 While we agree with the answer, we do not express any view on whether it would be beneficial to allow entities to apply IFRS 9 instead of IAS 39. However, we expect that this will be considered in relation to the review of the IFRS for SMEs that is currently expected to take place in 2012.

Recycling of cumulative exchange differences on disposal of a subsidiary

Notes to EFRAG's constituents

7 *Paragraph 30.13 of the IFRS for SMEs specifically prohibits recycling of exchange differences arising on translation of a monetary item that forms part of a net investment in a foreign operation in non-separate financial statements.*

8 *Paragraph 30.18 deals with the use of a presentation currency other than the functional currency. It states that an entity whose functional currency is not the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the following procedures:*

(a) *Assets and liabilities for each statement of financial position presented (i.e. including comparatives) shall be translated at the closing rate at the date of that statement of financial position.*

(b) *Income and expenses for each statement of comprehensive income (i.e. including comparatives) shall be translated at exchange rates at the dates of the transactions.*

(c) *All resulting exchanges shall be recognised in other comprehensive income.*

9 *The question raised in the draft Q&A is whether it is prohibited to recognise the cumulative exchange differences that arise on translation into a presentation currency in profit or loss on disposal of the subsidiary. Contrary to paragraph 30.13, paragraph 30.18 does not explicitly prohibit this.*

10 *The answer provided in the draft Q&A states that it is prohibited to recycle the cumulative exchange differences into profit or loss. This follows from paragraph 9.18 that explains that when a subsidiary is sold, "[t]he difference between the proceeds from the disposal of the subsidiary and its carrying amount as of the date of disposal, excluding the cumulative amount of any exchange differences that relate to a foreign subsidiary recognised in equity in accordance with Section 30 Foreign Currency Translation, is recognised in the consolidated statement of comprehensive income (or the income statement, if presented) as the gain or loss on the disposal of the subsidiary".*

View of EFRAG:

- EFRAG does not think the Q&A should be issued.

11 EFRAG agrees that paragraph 30.18 of the IFRS for SMEs does not specify whether cumulative exchange differences that arise on translation into a presentation currency should or should not be recognised in profit or loss on disposal of the subsidiary.

12 However, we do not consider this to be a problem as paragraph 30.18 deals with other currency translations than only those made by a subsidiary for consolidation purposes. Therefore, we do not consider that the answer to the raised question has to be found in paragraph 30.18. Instead, we think, as indicated in the draft Q&A, that paragraph 9.18 is a suitable place to address the issue.

13 However, paragraph 9.18 may not appear sufficiently clear. The punctuation seems unhelpful and 'excluding' could be interpreted as meaning 'minus'. The paragraph could therefore be interpreted as saying that the cumulative amount of any exchange differences shall be deducted from the difference between the proceeds from the disposal of the subsidiary and its carrying amount, and be recognised in the consolidated statement of comprehensive income (or the income statement, if presented).

14 The fact that paragraph 9.18 may not be sufficiently clear could warrant a Q&A. However, we think it would be better to clarify the standard. For example, we think

an editorial correction could be issued to relocate the first comma in the third sentence of paragraph 9.18 as follows:

> The difference between the proceeds from the disposal of the subsidiary, and its carrying amount as of the date of disposal~~,~~ excluding the cumulative amount of any exchange differences that relate to a foreign subsidiary recognised in equity in accordance with Section 30 Foreign Currency Translation, is recognised in the consolidated statement of comprehensive income (or the income statement, if presented) as the gain or loss on the disposal of the subsidiary.

The comma is thus placed after 'subsidiary' instead of after 'disposal'.

15 We also think that until the standard is amended, entities that would encounter the particular issue could find the answer to the issue by studying the Basis for Conclusion. The Basis for Conclusion seems very clear on the issue. Paragraph BC123 thus reads:

> IAS 21 requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation. In the financial statements that include the foreign operation and the reporting entity (e.g. consolidated financial statements when the foreign operation is a subsidiary), IAS 21 recognises such exchange differences initially in other comprehensive income and reclassifies them from equity to profit or loss on disposal of the net investment. The *IFRS for SMEs* provides for one difference: an exchange difference that is recognised initially in other comprehensive income is not reclassified in profit or loss on disposal of the investment. The reason for the difference is that not requiring reclassification is less burdensome for SMEs because it eliminates the need for tracking the exchange differences after initial recognition.

16 We acknowledge that SMEs should generally not be expected to read the Basis for Conclusion. However, we expect that the issue will only be relevant for few SMEs. Until the standard itself is clarified we therefore think that the cost of introducing more guidance, all entities preparing financial statements in accordance with the IFRS for SMEs will have to study, outweighs the benefit for the few entities for which this is assessed to be an issue.

17 Therefore we do not think the Q&A should be issued.