Attachment 2: Detailed comments on existing sections

A – Comment on scope

1 – Clarification needed on changes in scope of the different sections in IFRS for SMEs compared to full IFRSs

According to the IASB, the proposed IFRS for SMEs is intended to be a comprehensive stand-alone document for SMEs and has been developed by the IASB by:

(a) extracting the fundamental concepts from the IASB Framework and the principles and related mandatory guidance from IFRSs (including Interpretations), and

(b) considering the modifications that are appropriate based on user needs and cost-benefit considerations (BC66).

The Basis for Conclusions, paragraphs BC70-BC93, explains the significant simplifications that the IASB is proposing to the recognition and measurement principles in IFRSs and the reasons for the proposals. However, the Basis does not explain why the scope of the different sections in the proposed IFRS for SMEs is different from the scope in IFRSs, from which the content of the SME sections has been extracted.

We understand that some of the differences in scope of the SME sections compared to full IFRSs are a consequence of the scope as defined in section 1 of the proposal for IFRS for SMEs. However, in our view, not all the differences in scope result from such a consequence. Furthermore, the use of a paragraph on scope or only a “definition” paragraph is inconsistent from section to section.

To avoid any misunderstandings We believe it is necessary for the IASB to clarify why there are differences in the scope of the sections in IFRS for SMEs compared to the full IFRSs. In our view, the clarifications should be included in the Basis for Conclusions. For example, contrary to IAS 18 Revenue section 22 Revenue does not exempt revenue arising from the extraction of minerals ores. We are not sure we understand the reasoning why section 18 does not include a similar exception. The rationale as to why this difference in scope exists is also not explained in the Basis for Conclusions.

B – Section 1: Scope

The scope of the exposure draft is based on the definition of “publicly accountable entities”, the intention being that the scope of this standard be restricted in order not to include “publicly accountable entities”.

1 – “IFRS for SMEs” is not the right label

As acknowledged in the Preface (paragraph 10), many jurisdictions around the world have developed their own definitions of the term SME for a broad range of purposes including prescribing financial reporting obligations. As indicated, those definitions often include quan-

tified criteria. Although the definitions and quantified criteria may vary from one jurisdiction to another, the "label" SME seems to be consistently used in order to refer to the size of entities.

However, the "publicly accountable" definition used by the IASB and which in essence forms the basis of the scope of this standard does not refer to size in anyway. Publicly and non publicly accountable entities may be small, medium-size, large or extremely large. We therefore believe that the IASB ought to revisit the labelling, as the existing labelling – SMEs – refers to a notion that is very different from what the definition of publicly accountability intends to capture. As such, it is somewhat misleading and has already led to numerous misunderstandings in various discussions that have taken place on this issue.

For that reason, we recommend that the IASB adopts for this standard a label more descriptive of the scope of the standard. Although we do not find a negative labelling very attractive, we would suggest "IFRS for NPAEs" (IFRS for non-publicly accountable entities) to be adopted instead of "IFRS for SMEs", as had been briefly envisaged in 2005 (BC53-54). We disagree that because of the way the IASCF objectives have been restated, it is necessary for the IASB to stick to the "for SMEs" label. Instead, we would suggest the IASB- to give priority to promoting a clear understanding of the scope of this standard.

2 – The notion of "fiduciary capacity" needs either to be explained or to be replaced

In addition to publicly listed entities, the scope excludes entities that "hold assets in a fiduciary capacity for a broad group of outsiders".

We understand from the Basis for Conclusions (BC36) that this description intends to exclude financial institutions such as banks and insurance companies and other similar entities. On the basis of that understanding, we support the definition of public accountability as proposed by the IASB.

However, there appears to be a lack of common understanding of what "fiduciary capacity" should encompass and the potential difficulty that this choice of terminology might create when the standard is translated into other languages. Generally, native English speakers interpret the term "fiduciary capacity" to mean a "form of management of assets" on behalf of others, i.e. assets which would neither be accounted for as the entity's own assets, nor generate liabilities of the entity to a broad group of outsiders. We therefore recommend that an explanatory definition be included in the glossary or another description be given in the standard. This will be helpful to avoid any misunderstanding of the definition of public accountability and, to ensure that all jurisdictions have a clear understanding of what type of entities the standard is intended for.

3 – Leaving a lot of freedom to jurisdictions is likely to make the standard as useful as possible

In our response to the first discussion paper, we had also stressed that as much freedom as possible should be left to jurisdictions in defining which entities should be allowed to use IFRS for SMEs. We are pleased to note that these comments have been fully taken into account as reflected in BC33 -44.

4 – No link ought to be established between the scope and the conformity with the "IFRS for SMEs"

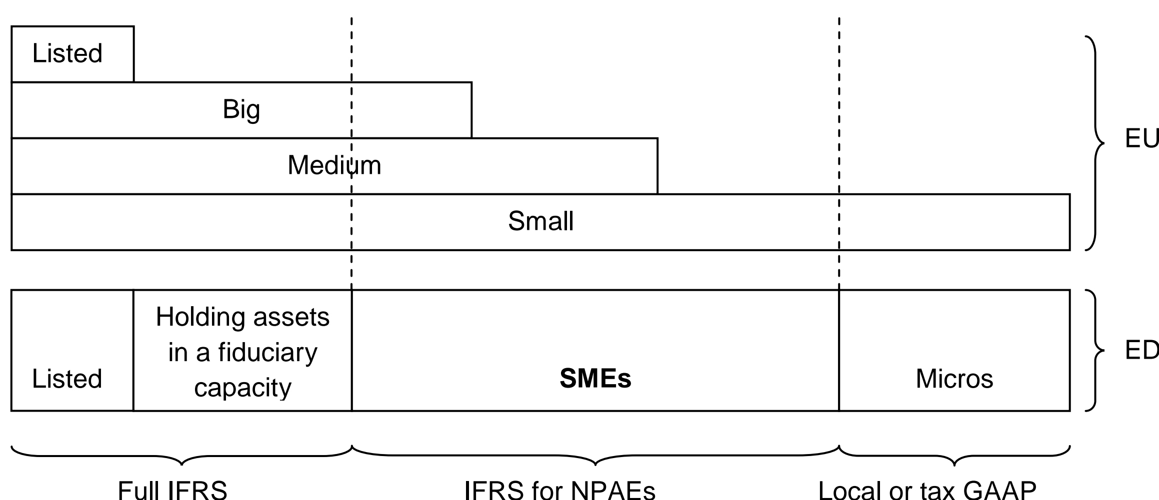
Conformity with a standard or a set of standards in the usual acceptance indicates that all accounting and disclosure requirements included in the standard(s) have been appropriately

satisfied. In our view, whether financial statements are "in conformity with the IFRS for SMEs" is not dependent on the nature or the structure of the entity.

As a consequence we believe that the condition set in par 1.3 should be removed. The definition of public accountability is helpful in conveying to jurisdictions that the IFRS for SMEs has been intended for non publicly accountable entities. In order to adequately draw the attention of users, publicly accountable entities may be required to disclose that although they are publicly accountable they apply the IFRS for SMEs in accordance with the legal requirements of their jurisdictions. However, it should not preclude those entities from including an explicit statement that their financial statements have been prepared in accordance with the IFRS for SMEs if indeed they are in conformity with the standard.

5 – Size is definitely not a relevant criterion in assessing the applicability of the IFRS for SMEs and every reference to size ought to be removed.

We illustrate below the potential scope of IFRS for SMEs as it could apply in the European context.



As shown in the above illustration, a great variety of entities, ranging from rather large private-equity entities to micro-entities are scoped in the proposed ED. As indicated above, we agree with the IASB that permitting individual jurisdictions the freedom to decide for which entities the IFRS for SMEs ought to apply, is consistent with a principle based approach to standard setting.

In our view, full IFRS should not be required for non publicly accountable entities whatever their size. Large entities, on one side of the spectrum, may at some stage in their development, decide to opt for full IFRS for various reasons. For example, in order to produce financial information that is comparable to that being reported by some of their competitors who are listed companies and report under IFRS, or because they enter into very sophisticated transactions that, in their view, would be best accounted for under IFRS, or because some of the users of their financial reporting (banks or rating agencies) require it. Nevertheless, until such circumstances do arise, the IFRS for SMEs is likely to adequately serve their financial statements users' needs.

On the other side of the spectrum, jurisdictions may decide to exempt very small entities from issuing general purpose financial statements, altogether, or to derive from the IFRS for SMEs a further simplified version of accounting standards applicable to micros, that they

would publish as their national GAAP for micros. At this end of the spectrum, such decisions may be made on very stringent cost/benefit trade-offs.

For these reasons, we believe that the IFRS for SMEs is likely to be suitable for a wide range of entities. In our view, the cost of financial reporting need not be increased just because larger entities would be able to afford it, although, there would be no specific user need identified.

Consequently, we believe the IASB should refrain from mentioning any reference to size. Although we understand the need for the IASB to refer to some practical representation in respect to the entities for which they are setting standards, we believe that the reference to 50 employees should be omitted from the Basis for Conclusions:

(a) differences from IFRS are to be derived primarily from different users' needs (see our analysis below) and/or in order to satisfy a more stringent cost/benefit constraint; the reference to 50 employees brings the focus back to size criteria instead of concentrating on what needs to make financial reporting different;

(b) there is no further reference to that criterion in the Basis for Conclusions, to assert the relevance of the reference;

(c) a number of employees is not, in itself, a relevant depiction of complexity or of economic significance; some labour intensive manufacturing entities, for example, may employ many more people although their operations do not require them to enter into sophisticated transactions, whereas some capital venture entities may employ a very small number of employees and still require quite sophisticated financial reporting; and

(d) 50 employees may vary in significance from one economic environment to the next; therefore the reference to a specific size is not relevant, for the same reasons why the IASB excluded setting defined size criteria.

6 – Is the supplementary criterion (publication of general purpose financial statements) useful?

In our view, whether or not an entity publishes general purpose financial statements should not be factor used to determine whether it is an "SME". We therefore recommend the second criterion in the definition of SME to be removed (paragraph 1.1 b)).

However, we believe that this section of the standard could include reference to the publication of general purpose financial statements, indicating, for example, that "this standard has primarily been designed for the preparation of general purpose financial statements".

C – Section 2: Concepts and pervasive principles

1 – Objectives of financial statements of SMEs, qualitative characteristics, definitions of elements and recognition criteria

EFRAG welcomes the full IFRS framework as the conceptual basis for the IFRS for SMEs.

Decision usefulness is one main objective of financial statements of SMEs. EFRAG also believes that, beyond that objective, financial statements must also show the results of management's stewardship of the resources entrusted to it. However, decision usefulness is largely dependent on who the users are, how they work, how they are organised and how

sophisticated they are. As a result, accounting requirements that are developed for listed entities might meet the objective of decision usefulness for those entities and yet, might not be suitable for users of SMEs.

EFRAG agrees that financial statements of SMEs should meet the qualitative characteristics described in section 2: understandability, relevance, reliability and comparability. EFRAG believes that sub-characteristics such as materiality, timeliness, substance over form, prudence, completeness and balance between benefit and cost should be shown as such. Furthermore, EFRAG believes that neutrality should not have been eliminated as it ought to apply to financial statements of SMEs as it applies to financial statements of other entities. However, there again an analysis of who the users are should indicate what type of accounting requirements are needed to ensure that these qualitative characteristics are met in an SME environment. For example, understandability which refers to “reasonably knowledgeable users” should be met for users who are “reasonably knowledgeable” in an SME environment.

Consistent with our first set of comments in response to the IASB’s DPs on SMEs, EFRAG believes that the IFRS for SMEs should be based on the same definition of elements as in full IFRS. EFRAG also supports the two recognition criteria, based on probability and reliability, which we believe are particularly important to SMEs. Maintaining that level of consistency with full IFRSs is necessary to ensure that the IFRS for SMEs plays a significant role in serving the IASCF’s objectives appropriately.

In EFRAG’s supplementary comments to invitations to comment in Attachment 1, EFRAG has described how EFRAG believes users’ needs in an SME context may differ from the needs users might have in a listed entity environment. In its response to the IASB questionnaire on simplifications to recognition and measurement, EFRAG described,how in its view, users’ needs might differ. EFRAG had also stressed its view that it was essential that a specific analysis of users’ needs be conducted to enhance the relevance of the IFRS for SMEs. EFRAG believes that in the absence of such an analysis, setting the objective as is done in section 2 of the IFRS for SMEs is meaningless.

2 – Measurement Pervasive Principles

EFRAG welcomes the introduction of measurement pervasive principles as part of the IFRS for SMEs. Measurement pervasive principles are indeed necessary to have the IFRS for SMEs as a stand-alone document. Furthermore, EFRAG agrees with, and commends the IASB for, having designed the hierarchy as described in paragraph 10.3 of the draft standard.

Nonetheless, to be truly useful and to best serve the consistency of financial reporting in accordance with the IFRS for SMEs, measurement pervasive principles must be clear and applicable to all transactions which are not specifically covered in the sections of the IFRS for SMEs. Having said that, EFRAG is concerned that the IFRS for SMEs might not be so clear in this respect and, rather than setting out the principles and clearly articulating when these principles are applicable, the IASB has merely listed some examples of existing measurement requirements, hence suggesting that the hierarchy does no better than simply operating by analogy. In our view, the measurement pervasive principles should be clearly set-out in the proposed standard to enable the IFRS for SMEs to be fully workable.

Keeping in mind that measurement pervasive principles apply to assets and liabilities not specifically addressed in the present draft standard, EFRAG recommends amending the proposals to limit the measurement pervasive principles to the following:

(a) all assets and liabilities are to be accounted for at cost at initial recognition;

(b) all liabilities are to be accounted for at cost or amortised cost or discounted current settlement value, subsequently;

(c) all assets are to be accounted for subsequently based on either a cost model or revaluation model. When to apply the cost and revaluation models and how to select either of these models should be explained in the appropriate sections of an appendix of the IFRS for SMEs, as application guidance for the standard. (Please refer to our Illustrative example in Attachment 3 (appendix 3 – AG1).

The rationale for these recommendations is explained in Attachment 3, appendix 4 to this letter (Basis for our conclusions on measurement).

D – Sections 3 to 8: Presentation of financial statements

Overall EFRAG agrees with the content in the sections on presentation of financial statements. However, EFRAG has the following comments in respect to the requirements on recognition and measurement:

(a) distinction between revalued assets and assets carried at cost should be made in the balance sheet (please refer to our answer to question 2 – paragraph 8);

(b) changes in value of assets carried at current value ought to be shown in the income statement separately from other gains and losses, as part of profit and loss (please refer to our answer to question 2 – paragraph 8);

(c) some changes should not, in EFRAG's view, be presented as part of profit and loss: they include actuarial gains and losses arising from a change in a net defined benefit obligation, changes in value of cash flow hedging instruments and foreign currency exchange differences (please refer to our comments in the relevant sections below). EFRAG suggests that these items be systematically presented in a SORIE in a separate category of equity. Recycling of cash flow hedges should also be discussed in the presentation section that addresses the income statement and the statement of changes in equity; and

(d) EFRAG has not yet dealt with disclosures. Comments, if any, are still to come.

E – Section 9: Consolidated Financial Statements and separate financial statements

1 – Supportive of requirement to prepare consolidated financial statements

EFRAG agrees with the IASB that SMEs should be required to prepare consolidated financial statements.

2 – Supportive of one single accounting policy for all investments in subsidiaries, jointly controlled entities and associates in the separate financial statements

Paragraph 9.18 requires a parent entity to adopt a policy of accounting for all of its investments in subsidiaries, jointly controlled entities and associates either at cost or at fair value through profit and loss in its separate financial statements. We agree that the entity should apply a consistent measurement method for all these investments and not only for each category of investments. Furthermore, we support the option that permits an entity to apply either cost or fair value (or rather either cost or current value as we believe fair value should be replaced with current value –please refer to our answer to question 2 paragraph 8)

through profit and loss when measuring the investments in the separate financial statements.

3 – Proposal to limit the measurement principles to cost or fair value only for both jointly controlled entities and investments in associates in the consolidated financial statements (Section 13 and 14)

In BC83 it is argued that many preparers of SME's financial statements questioned the usefulness of measuring its investment in associates when applying the equity method and the usefulness of measuring its investment in jointly controlled entities by either applying the equity method or proportionate consolidation. The preparers had expressed that they have particular difficulty in applying these methods because of the inability to obtain the required information and the need to conform accounting principles and reporting dates. We support allowing either cost or fair value (or rather cost or current value – as we believe fair value should be replaced with current value – please refer to our answer to question 2 paragraph 8) to be applied in the consolidated financial statements for both investments in associates and jointly controlled entities. However, this allows three options (cost, equity and fair value) for subsequent measurement of investments in associates and four options (cost, equity, proportionate consolidation and fair value) for subsequent measurement of investments in jointly controlled entities in the consolidated financial statements. Based on the arguments in BC83 that support allowing an entity to use either cost or fair value, we believe that the measurement principles could be simplified by only allowing cost and fair value as measurement principles in the consolidated financial statements which, in accordance with paragraph 9.18, are the principles to be applied in the entity's separate financial statements for such investments.

4 – Elimination of cross-reference to IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures (Section 13 and 14)

Section 13 and 14 include cross references to IAS 28 when applying the equity method and to IAS 31 when applying proportionate consolidation. As mentioned in our response to question 1 of the invitation to comment, we believe that this Standard needs to be a stand- alone document, which means the cross-references to IAS 28 and IAS 31 should be deleted and the necessary requirements included in the section itself or as proposed, (please refer to our restructuring and redrafting proposals), in a separate section dealing with application guidance on group accounting.

If the IASB accepts our suggestion to simplify the measurement principles for investments in Associates and interests in Joint Ventures, the need for this cross-reference would be unnecessary.

5 – Comments on drafting

The structure of the SME sections is that most definitions are included in the glossary. However a definition or explanation of the cost model is neither included in the glossary nor in section 9. Such a definition is needed to clarify how to account for income from an investment in a subsidiary, when applying the cost model in the separate financial statements. Both section 13 *Investments in Associates* and section 14 *Investments in Joint Ventures* (in paragraphs 13.4 and 14.9 respectively) include explanatory guidance on the application of the cost model We believe that similar guidance on how the cost model should be applied is necessary to clarify the accounting for investments in the separate financial statements of an entity. Our restructuring and redrafting proposals (to develop a section that addresses group accounting, and would require including sections 9, 13, 14 and 18 and some other relevant extracts (intangible assets purchased in business combinations, foreign currency require-

ments applicable to consolidation) in one section), would avoid having to repeat the definitions and would solve the comment on drafting.

We believe that the standard needs to clarify that the accounting for investments in jointly controlled entities in section 14 *Investments in joint ventures* and the accounting in section 13 *Investments in Associates* will only apply to the consolidated financial statements. On the other hand, section 9 *Consolidated and Separate Financial Statements* will apply when accounting for these investments in the separate financial statements of the entity. We believe that such clarification is needed because different measurement principles are to be applied in accordance with sections 13, 14 and 19 respectively. This comment would be solved if the IASB accepted and took account of our proposals for restructuring and redrafting the standard (one single section on group accounting).

F – Section 10: Accounting Policies, Estimates and Errors

1 – Too burdensome to require SMEs to change its accounting policy in accordance with the transitional provisions of full IFRS, if an amendment is made

The ED proposes that when the IFRS for SMEs requires or permits an entity to follow the requirement(s) of a full IFRS and the requirement(s) of that IFRS change(s), paragraph 10.9b requires the entity to account for that change in its accounting policies in accordance with the transitional provisions, if any, specified in that IFRS. The requirement in paragraph 10.9b is a consequence of the use of cross-references to the full IFRSs in the IFRS for SMEs. Application of paragraph 10.9b means that *any* amendment to an IFRS in full IFRS that is applied via a cross-reference has to be applied by SMEs. EFRAG believes that this requirement will be extremely burdensome for SMEs because it means that SMEs have to be up-dated on all the amendments to both the full IFRSs and the IFRSs for SMEs, simply because they choose to apply an option that is available by means of a cross-reference to full IFRS. This highlights the importance as to why the IFRS for SMEs needs to be a stand-alone document. We refer to our response to question 1 in the invitation to comment.

2 – Comments on drafting

EFRAG supports retrospective application for changes in accounting policies. However, we believe that part of the wording of paragraph 10.10 needs to be changed. The paragraph as written requires the entity, in situations when it is impracticable to determine the individual period effects of changing an accounting policy for one or more prior periods presented, to adjust the opening balance of each affected component of equity for the earliest prior period for which retrospective application is practicable, which may be the current period, and to record a corresponding adjustment to the opening balance of each affected components of equity for that period.

This means that both the credit and the debit adjustments are recognised in equity. We believe that the correct wording is that an adjustment is made to each affected components of equity and a corresponding adjustment is made to the carrying amount(s) of assets or liabilities.

G – Section 11: Financial assets and financial liabilities

Please refer to our answer to question 2 (paragraph 1) in the invitation to comment.

H – Section 12: Inventories

We have no comments on this section.

I – Section 13: Investment in associates and 14: Investment in Joint Ventures

Our comments on section 13 and 14 are included in the comments to Section 9 *Consolidated and Separate Financial Statements* (of this attachment). We refer to those comments.

J – Section 15: Investment property

1 – Guidance on accounting for lease transactions which is included in the scope of the section is not sufficient

According to section 19 Leases, section 15 applies to "property held by lessees that is accounted for as investment property" and "investment property provided by lessors under operating leases".

(a) Property held by lessees that is accounted for as investment property – the financial statements of the lessee

Section 15 does not provide further guidance on the accounting of "property held by lessees that is accounted for as investment property", other than stating in paragraph 15.2 "that a property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, the property would otherwise meet the definition of an investment property and the lessee uses the fair value model for that property and for all of its other property classified as investment property". We also refer to our comments on scope within section 19 in paragraph N below.

We believe that the option to account for a property interest that is held by a lessee under an operating lease as an investment property adds unnecessary complexity to section 15 *Investment Property* and section 19 *Leases*. In our view, the option should not be part of the IFRS for SMEs. However, if the IASB decides that the IFRS for SMEs should continue to allow a property interest that is held by a lessee under an operating lease to be classified and accounted for as investment property, we believe that more detailed guidance is needed in section 15 *Investment Property*.

(b) Investment property provided by lessors under operating leases – the financial statements of the lessor

We agree that the measurement principles in section 15 should apply to "investment property provided by lessors under operating leases". However, section 15 only provides guidance on the basis of measurement of the investment property, and does not provide any guidance in respect of other aspects of the accounting for operating leases in the financial statements of the lessors. For that reason, we believe those transactions should be scoped out of section 19 but only in relation to measurement of the investment property. Regarding all others aspects of the accounting requirements in respect to lease transactions, section 19 should apply.

We believe this inconsistency between section 15 and 19 needs to be removed.

2 – Elimination of cross-reference to IAS 40 *Investment Property*

The section includes a cross reference to IAS 40 in respect to the application of the fair value model. As explained in our response to question 1 in the invitation to comment, we believe that the IFRS for SMEs needs to be a stand-alone document, which means the cross-reference to IAS 40 should be eliminated and the necessary requirements included in the section itself or amended as proposed in our alternative structure in Attachment 3 (appendix 1 and 2) to this letter, where we address the accounting principles for non-financial assets and application guidance on measurement of non-financial assets.

K – Section 16: Property, Plant and Equipment

1 – Both the cost model and revaluation model should be retained as subsequent measurement

EFRAG supports the proposal that both the cost model and revaluation model should be retained for SMEs for Property, Plant and Equipment. However, we believe that the models should no longer be optional; rather, they should be mandatory when certain criteria are fulfilled. This approach is illustrated in Attachment 3 (appendix 3) of this letter. We refer to our basis for recommendations provided in paragraph 8 of our response to question 2 in the invitation to comment.

2 – Comments on drafting

Section 16 does not include the recognition criteria which determine whether an item of property, plant and equipment can be recognised. The reasoning may be that the recognition criteria that should be applied are the general recognition criteria in paragraph 2.24. However, if our understanding is correct, this approach would be inconsistent with the approach adopted in paragraph 17.2 *Intangible Assets other than Goodwill*, where the recognition criteria are repeated even though a reference is made to paragraph 2.24. The use of references back to the pervasive principles of section 2 should be used consistently throughout the sections. Our drafting proposals, as illustrated in Attachment 3, appendix 2, solve this type of issue.

L – Section 17: Intangible Assets other than Goodwill

1 – All intangible assets (including goodwill) should be accounted for as assets with a finite life and be amortised

Please refer to our response to question 2 (paragraph 4) in the invitation to comment.

2 – Supportive of the expense model

EFRAG agrees that SMEs should be allowed to expense costs incurred in both research and development activities, as and when incurred. We support this proposal because we believe users do not need internally-generated intangible assets to be capitalized in order to assess the entity's ability to pay its liabilities in the short- and medium-term. Furthermore, it eases the burden for the preparers who would no longer have to demonstrate whether the recognition criteria have been met or not. We agree with the proposal in paragraph 34 that the option to apply the expense model for development costs should be supported by disclosure of the aggregate amount of research and development costs recognised as an expense during the period.

3 – The revaluation model should not be retained for intangible assets

EFRAG believes that the revaluation model for intangible assets should not be retained for SMEs. In our view, the option to apply the revaluation is rarely used by listed entities, and for that reason we believe it will be uncommon for SMEs to apply this option.

4 – Emphasise that internally generated goodwill shall not be recognised

The SME standard should emphasise that internally generated goodwill shall not be recognised as an asset. Please refer to our illustrative example in Attachment 3, appendix 2.

M – Section 18: Business Combination and goodwill

1 – The requirement to allocate the cost of the business combination to contingent liabilities should be eliminated

EFRAG agrees that all business combinations shall be accounted for by applying the purchase method. However, we suggest simplifying the method for allocating the cost of a business combination by eliminating the requirement to allocate contingent liabilities. In our view, recognising such liabilities would be inconsistent with the recognition criteria in section 2.

N – Section 19: Leases

1 – Assets and liabilities in a finance lease should be measured at an amount equal to the present value of the minimum lease payments and not fair value

Please refer to our response to question 2 (paragraph 3) in the invitation to comment.

2 – Some change to the scope is needed

Paragraph 1 (c) and (d) of section 19 exempt "property held by lessees that is accounted for as investment property" and "investment property provided by lessors under operating leases" from the scope of the section. Both the exemptions refer to section 15 *Investment Property*. Accordingly, section 15 should apply when accounting for such lease transactions. As mentioned in our comments to section 15, we do not find that section 15 provides sufficient guidance on the accounting of these 2 exemptions.

Furthermore, we believe that the transactions should only be exempt in respect to the basis of measurement. In our view, the remaining requirements in section 19 would still apply for such transactions.

The way we interpret paragraph 16 of section 19 (see next paragraph), means that essentially we believe that as a consequence of paragraph 16, section 15 *Investment Property* will apply as the basis of measurement for "investment property provided by lessors under an operating lease" **without** exempting these transactions from the scope of section 19. This means that exemption (d) in paragraph 1 is in our opinion not necessary. We believe proper justification needs to be provided in the Basis for Conclusion, if these scope exemptions are to be retained.

As previously mentioned in our comments to section 15, we believe that the option to account for a property interest that is held by a lessee under an operating lease as an investment property, should be removed.

3 – Our interpretation of paragraph 16 of section 19 – the financial statements of the lessors – operating lease

We question the requirement in paragraph 16 of section 19, which states that a lessor "shall present assets subject to operating leases in its balance sheet in accordance with the nature of the assets". Our interpretation of paragraph 16 is that, for example, if a lessor leases out a tangible asset under an operating lease – the tangible asset is recognised and measured in the financial statements of the lessor (operating lease) in accordance with the requirements of section 16 *Property, Plant and Equipment* and, for an investment property section 15 *Investment Property* would apply in order to recognise and measure the investment property etc.

We suggest expanding the meaning of paragraph 16 to avoid misinterpretation.

4 – Elimination of cross-reference to IAS 17 *Leases*

The section includes a cross reference to IAS 17 regarding the accounting for finance leases in the financial statements of the lessor. As explained in our response to question 1 in the invitation to comment, we believe that this standard needs to be a stand- alone document, which means that the cross-reference to IAS 17 should be omitted and the necessary accounting requirements included in the IFRS for SMEs.

Our understanding is that lessors are not necessarily publicly accountable entities, as their operations may be financed without the need to raise funds from the public. However, as indicated in our comments on section 1 above (Scope), we do not have a clear understanding of the meaning of "fiduciary capacity" and for that reason, cannot conclude whether within the context of "fiduciary capacity" a lessor might be considered to be a publicly accountable entity.

5 – Comments on drafting

In accordance with paragraph 19.11 a lessee will be required to depreciate an asset leased under a finance lease in accordance with section 16 *Property, Plant and Equipment.* However, no reference is made to section 17 "Intangible Assets", in case of a finance lease of an intangible asset.

The subsequent measurement principles (paragraph 19.9-19.11) in respect to the accounting for finance leases in the financial statements of a lessee do not include a reference to section 26 *Impairment of Assets* in order to determine whether the leased asset has become impaired. We believe that such a reference should be included as part of the measurement principles.

In our response to question 2 (paragraph 8) of the invitation to comment, we suggested having application guidance on the measurement of non-financial assets. We believe that paragraph 19.11 could be replaced with a paragraph referring to the accounting requirements for non-financial assets, stating that following initial recognition, the asset be recognised and presented as it would be, had the ownership rights been purchased. The guidance we propose includes the accounting for impairment. By doing this, our comments above would be solved and repetition would be avoided. Here again, our recommendations on drafting would solve this type of issue.

O – Section 20: Provisions and Contingencies

1 – No liability arising from executory contracts should be recognised

In the exposure draft, no mention is made of executory contracts. In the absence of any specific exemption, accounting of related assets and liabilities would be required. For that reason, we believe that the section should explicitly state that executory contracts are exempt from its scope.

2 – Other comments

We agree with section 20 and in particular that measurement requirements should focus on settlement, as we believe that provisions and contingencies are hardly ever transferable. We suggest that paragraph 20.8 be written as follows: "at the best estimate **at the reporting date** of the amount required to settle the obligation" (to make it clear that the best estimate reflects current economic conditions at the reporting date and NOT a settlement scenario at the reporting date).

P – Section 21: Equity

1 – Missing or outsourced definitions make the section difficult to read

EFRAG has the view that this section is difficult to understand for users and preparers of SME's financial statements, primarily because the core material from which it is drawn (ie IAS 32) is also confusing. EFRAG has concluded that, bearing in mind the definition of a financial liability in the glossary of the ED, the accounting of equity for an SME is not simplified. EFRAG believes that the section would be easier to read were "equity shares" to be defined and were a reference to financial liabilities included in section 21 to avoid misunderstandings of the meaning of equity.

2 – Definition of financial liabilities leads to doubtful or no distinction between equity and liability

In EFRAG's view, the IASB did not take into account the different company laws SMEs might have to follow compared to listed companies. For example, partnerships and cooperatives are quite common legal forms for SMEs. For those entities, in some European legal environments, the current definition of financial liabilities might not give a true and fair view of the financial position of the entity, This is because the members in these legal forms often have individual rights (e.g. a right to put the shares back to the entity due to the shares not being tradable at all). The current distinction is based on liabilities; liabilities being certain obligations which are being defined as individual rights, the exercise of which potentially results in an outflow of resources the entity cannot avoid. Thus, in every legal form in which a membership is associated with individual rights, the entity will only present liabilities and no equity. In our view, this presentation does not reflect the economic situation in an appropriate manner.

We are also concerned that the acceptance and the willingness to apply the IFRS for SMEs in Europe will be significantly reduced if these SMEs conclude that their economic situation is not properly reflected in the financial statements. We believe that an entity will be very reluctant to apply the IFRS for SMEs if - due to its legal form - the standard does not permit them to represent equity in a way that is appropriate.

This, in EFRAG's view, calls for an exception to be granted to the definition of liabilities in section 2 of the ED (or an exception to equity being defined as the residual interest in the

assets of the entity after deducting all its liabilities). EFRAG believes that the conceptual basis of the IFRS for SMEs should remain consistent with the IFRS framework. The change to be made should be similar, but not limited to, what the IASB is considering for full IFRS.

3 – Other comments

EFRAG agrees with the principles set out in section 21 stating that an entity should measure the equity at the fair value of the cash or other resources received or receivable, net of direct costs of issuing the equity shares.

EFRAG also agrees with the accounting requirements for compound financial instruments and, that an SME shall deduct the fair value of the consideration given for treasury shares from equity.

However, we disagree with the requirements set out in paragraph 21.11 regarding the accounting for transactions with the minority interests in a subsidiary that is consolidated. The reasons why we disagree are consistent with, our comments on the proposed amendments to IAS 27 *Consolidated and Individual Financial Statements*, as explained in detail in our comment letter to those amendments, dated November 28, 2005.

Q – Section 22: Revenue

1 – Comments on drafting

We believe that, as a consequence of including revenue from construction contracts in the scope of section 22, paragraph 1 of this section should explain that revenue transactions arising from construction contracts are transactions within its scope. To follow the structure of the section, we support having it as a separate sub-section. However, we would suggest that such guidance be included immediately after the guidance on transactions involving the rendering of services.

***2* – Guidance on the elements of contract revenue and contract cost are not included in the ED**

We believe that some guidance is needed. We refer to our illustrative example set out in Attachment 3, appendix 3. Should our drafting recommendations be followed, guidance on the accounting for contract costs could be included in the guidance that addresses the cost of inventories.

The illustrative examples in section 22 should include examples of both construction contracts and other revenue transactions covered by the section.

R – Section 23 Government Grants

As previously mentioned in our response to question 4 in the invitation to comment, we believe the model set out in the IFRS for SMEs on accounting for government grants is satisfactory. Consequently, we believe that the option to revert to IAS 20 should be deleted. The only argument in Basis for Conclusions that supports permitting the use of the other methods permitted by IAS 20 *Accounting for Government Grants,* is that all options should be available in the IFRS for SMEs, in the view that individual jurisdictions are free to remove options. In our view, the model in the IFRS for SMEs will satisfy the user's needs and is easy to understand and implement for SMEs.

S – Section 24 Borrowing Cost

Please refer to our response to question 5 of the invitation to comment.

T – Section 25: Share-based payments

1 – Equity settled share-based payment transactions should trigger disclosure only

Please refer to our response to question 3 (paragraph 1) of the invitation to comment.

2 – Measurement of liabilities incurred in a cash-settled share-based payment transaction should be simplified

Please refer to our response to question 3 (paragraph 2) of the invitation to comment.

3 – Transfer of equity instruments within the group

We believe that it would be useful to highlight the fact that section 25 also applies to transfers of equity instruments of the entity's parent, or equity instruments of another entity in the same group as the entity, to parties that have supplied goods or services to the entity.

U – Section 26: Impairment of Non-financial Assets

1 – Changes made to impairment requirements lack relevance and remain burdensome for goodwill

Please refer to our response to question 2 of the invitation to comment.

2 – Comments on drafting

In EFRAG's view, the heading "Impairment of non-financial assets other than inventories" is inappropriate mainly because in accordance with paragraph 13.4 of section 13 *Associates* the investor in associates shall recognise impairment in accordance with section 26. Similarly, reference to section 26 is also found in paragraph 14.9 of section 14 *Joint Ventures*. In other words, section 26 also addresses the impairment of some financial assets or at least the same principles are applied.

Paragraph 26.12 requires that an entity shall recognise an impairment loss immediately in profit and loss. Insofar as an entity can apply the revaluation model for both tangible assets and intangible assets the following sentence should be added: "unless the asset is carried at revalued amount in accordance with the revaluation model in section 16 *'Property, Plant and Equipment* and 17 *"Intangible Assets other than Goodwill"*.

V – Section 27: Employee Benefits

EFRAG's main comments on this section relate to unrecognised actuarial gains and losses and past service costs which are not mentioned in Section 27.15 in particular, regarding the measurement of a defined benefit liability.

1 – Presentation of actuarial gains and losses in the income statement

The so called "corridor approach" is not being made available to SMEs. In accordance with section 27.21 and 27.22(d) all actuarial gains and losses should be immediately recognised

in profit and loss. EFRAG agrees that this will mean a simplification for SMEs and EFRAG supports this. However, in EFRAG's view this raises an issue of presentation. EFRAG believes that actuarial gains and losses, that reflect changes that are considered to be of "a very long-term nature", ought to be presented in a SORIE. (Please see our comment on section 5 above).

2 – Treatment of unvested past service costs is not clear

Section 27 requires the immediate recognition of all (vested and unvested) past service costs. EFRAG is concerned about the wording in Section 27.19 which states that changes in a defined plan should be reflected by increasing or decreasing the defined benefit liability. The increase or decrease should be recognised as income or expense.

EFRAG suggests that the wording of Section 27 be amended to clarify whether the term "defined benefit liability" in Section 27.19 also includes unvested past service costs. If this is what is intended by Section 27, then EFRAG will disagree. In EFRAG's view, unvested past service costs should be recognised as an expense on a straight-line basis over the average period until the benefits become vested.

W – Section 28: Income Taxes

1 – Offsetting principles are missing for current taxes

Regarding current taxes, the recognition and measurement principles of the ED are similar to full IFRS. EFRAG generally supports that approach. However EFRAG believes that some principles should be added regarding the presentation of current income taxes because the ED does not contain any offsetting principles.

2 – EFRAG supports temporary approach for deferred taxes

Regarding deferred taxes, EFRAG refers to its response to the IASB Questionnaire, and welcomes the approach in the ED. EFRAG supports the use the temporary approach for deferred taxes, instead of a modified timing difference approach.

EFRAG agrees with the proposal in the ED to require deferred taxes to be recognised based on the book value/tax differences that arise in a business combination or on the initial recognition of an asset or liability.

Furthermore, EFRAG supports the ED's view that for unused tax losses to carry forward and tax credits, deferred tax assets should be recognised similar to the accounting for deductible temporary differences.

Questions to EFRAG constituents:

Transactions that do not affect accounting or taxable profit on the initial recognition

Different from IAS 12.15(b) and 12.24(b) paragraph 28.15 and 28.16(a) allow an SME to recognise deferred tax asset and liabilities for all temporary differences arising on the initial recognition of an asset or liability outside a business combinations regardless whether the transactions at that time affects accounting or taxable profit.

1. Do constituents think this is appropriate ?

2. Does this cause any problems considering your national tax environment ?

General simplification of deferred taxes

3. Do you have any other proposals to further simplify deferred tax accounting ?

X – Section 29: Financial Reporting in Hyperinflationary Economies

1 – Accounting of hyperinflationary economies needs to be included in the standard and cross-reference to full IFRS should be deleted

Please refer to our response to question 1 of the invitation to comment.

Y – Section 30: Foreign Currency Translation

1 – Relevant requirements related to hyperinflationary currencies should be included in the standard and cross-reference to full IFRS should be deleted

Please refer to our response to question 1 of the invitation to comment.

Z – Section 31: Segment Reporting

1 – Delete section 31 from IFRS for SMEs

Please refer to our response to question 1 of the invitation to comment.

AA – Section 32: Events after the end of the Reporting Period

1 – Clarification of the requirement to update disclosure about conditions at the balance sheet date

EFRAG believes that clarification is needed in section 32 so that it is clearly understood that disclosures in the financial statements need to reflect information received after the balance sheet date, even when the information does not affect the amount that is recognised in the financial statements.

BB – Section 33: Related Party Disclosure

Please refer to our response to question 9 of the invitation to comment.

CC – Section 34: Earnings per share

1 – Delete section 33 from IFRS for SMEs

Please refer to our response to question 1 of the invitation to comment.

DD – Section 35: Specialised Industries

1 – Agriculture: Cross-reference to full IFRS should be deleted and the accounting for agriculture should be scoped in non-financial assets

If an SME applies the fair value model to account for its biological assets, paragraph 35.1 requires that the SME apply the fair value model applied in IAS 41 *Agriculture*. As mentioned in our response to question 1 of the invitation to comment, we believe that the IFRS for SMEs needs to be a stand-alone document, which means the cross-reference to IAS 41 should be deleted. Furthermore, we believe this cross-reference is unnecessary. Please refer to our answer to question 2 (paragraph 8: "generalise cost or current value choice for all non-financial assets").

2 – No need to explain that insurance is not in the scope of the IFRS for SMEs

We believe there is no need to include a paragraph explaining the reasoning why insurance is not part of the IFRS for SMEs, as the scope of the IFRS for SMEs is already dealt with in section 1.

3 – Extractive Industries should be scoped in in other sections

We believe it is not necessary to deal with the accounting of extractive industries in a separate section. The accounting should be in the scope of the sections to which paragraph 35.2 already refers.

EE – Section 36: Discontinued Operations and Assets held for sale

Please refer to paragraphs 5 and 6 in our answer to question 2 of the invitation to comment.

FF – Section 37: Interim Financial Reporting

1 – Delete section 37 from IFRS for SMEs

Please refer to our response to question 1 of the invitation to comment.

GG – Section 38: Transition on the IFRS for SMEs

Please refer to our response to question 10 of the invitation to comment.