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.

31 January 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*

View of EFRAG: • EFRAG agrees with the answer provided in the draft Q&A.

1 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.

2 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.

3 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

View of EFRAG: • EFRAG does not think the Q&A should be issued.

4 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.

5 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.

6 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).

7 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.

8 We 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.

9 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.

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