

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.

30 November 2011

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:

- Application of the *IFRS for SMEs* for financial periods ending before the *IFRS for SMEs* was issued;
- Interpretation of ‘undue cost or effort’ and ‘impracticable’;
- Departure from a principle in the *IFRS for SMEs*;
- Prescription of the format of financial statements by local regulation; and
- Jurisdiction requires fallback to full IFRSs.

The draft Q&A *Application of the IFRS for SMEs for financial periods ending before the IFRS for SMEs was issued* considers whether an entity can apply the IFRS for SMEs for periods ending before the IASB issued the *IFRS for SMEs*. It is stated in the response that an entity can apply the standard for financial periods before the IFRS for SMEs was issued unless local regulation prohibits it.

The draft Q&A *Interpretation of ‘undue cost or effort’ and ‘impracticable’* explains how ‘undue cost or effort’ and ‘impracticable’ should be understood. According to the draft Q&A ‘impracticable’ generally only covers situations where information is unavailable, whereas it is stated that ‘undue cost or effort’ will depend on the specific circumstances and management’s professional judgement. In deciding whether applying a requirement would result in undue cost or effort, the cost and excessive endeavours by employees should be compared to the benefits the users of the financial statements would receive from having the information.

The draft Q&A *Departure from a principle in the IFRS for SMEs* considers whether an entity that chooses to use a principle that is not allowed under the IFRS for SMEs, but perhaps under (full) IFRS, can be described in any way as complying with the IFRS for

SMEs. The answer provided is that in such cases the entity may not state compliance with the IFRS for SMEs.

The draft Q&A *Prescription of the format of financial statements by local regulation* includes a response to the question on the impact of local requirements to apply certain formats for the financial statements on an entity's ability to state compliance with the IFRS for SMEs. The response states that, provided the prescribed format under local law and regulation meets the minimal basic formatting requirements in the IFRS for SMEs, the entity will be able to state compliance with the IFRS for SMEs.

The draft Q&A *Jurisdiction requires fallback to full IFRSs* considers whether an entity complies with the IFRS for SMEs if it is required to apply (full) IFRSs as a fallback every time a particular transaction, other event or condition, are not specifically covered by the IFRS for SMEs. The draft Q&A states that the entity would comply with the IFRS for SMEs when the IFRS for SMEs does not contain specific guidance on the particular transaction, other event or condition.

EFRAG would recommend the SMEIG not to issue any of the Q&As.

Similar to the concern expressed in our comment letter in response to the second batch of draft Q&As, we are concerned that the SMEIG is not focusing on a limited number of pervasive issues when issuing Q&As, as specified in its terms of reference and operating procedures.

We note that four of the Q&As consider issues on which the requirements of the IFRS for SMEs seem clear, and the answer to the question raised in the last draft Q&A (Interpretation of 'undue cost or effort' and 'impracticable') seems to depend on the SME's specific circumstances and management's professional judgement.

Our detailed comments on the 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

Introduction

- 1 EFRAG has decided to comment on the following draft Q&As in a single comment letter:
 - (a) Application of the *IFRS for SMEs* for financial periods ending before the *IFRS for SMEs* was issued;
 - (b) Interpretation of 'undue cost or effort' and 'impracticable';
 - (c) Departure from a principle in the *IFRS for SMEs*;
 - (d) Prescription of the format of financial statements by local regulation; and
 - (e) Jurisdiction requires fallback to full IFRSs.

EFRAG has chosen to do so, as it has some general comments.

- 2 Below, these general comments are explained. This is followed by our more detailed comments to each of the draft Q&As and some general comments to the last three draft Q&As.

General comments

View of EFRAG:

- EFRAG would recommend the SMEIG not to issue any of the Q&As.

- 3 EFRAG acknowledges that training material and Q&As constitute non-mandatory guidance and are issued in order to help preparers. However, we are worried that the material will be considered as the official interpretation of the IFRS for SMEs and thereby implicitly form part of the standard. By stating in the Terms of Reference and Operating Procedures for the SME Implementation Group, that it should focus on a limited number of pervasive issues and not seek to create an extensive rule-oriented environment, we assess that the International Accounting Standards Committee Foundation could have similar concerns. In addition, EFRAG could be concerned that the Q&As inappropriately could be applied to interpret (full) IFRS.
- 4 Besides creating rules in a principle-oriented environment, we think that the amount of training material and Q&As would not necessarily be regarded as a help, but as an extensive amount of additional literature a preparer would have to consider in order to be able to prepare financial statements in accordance with the IFRS for SMEs.
- 5 We therefore think it is necessary to be very selective on the Q&As to be issued and suggest not to issue any of the draft Q&As in the third batch of draft Q&As for the reasons set out below.
- 6 The third batch of draft Q&As considers the following issues:

- (a) Whether the IFRS for SMEs can be applied to financial periods ending before the standard was issued (one draft Q&A: *Application of the IFRS for SMEs for financial periods ending before the IFRS for SMEs was issued*);
 - (b) Interpretation of 'undue cost or effort' and 'impracticable' (one draft Q&A: *Interpretation of 'undue cost or effort' and 'impracticable'*);
 - (c) Whether financial statements not meeting all the requirements of the IFRS for SMEs can be said to be prepared in accordance with the IFRS for SMEs (three draft Q&As: *Departure from a principle in the IFRS for SMEs*; *Prescription of the format of financial statements by local regulation*; and *Jurisdiction requires fallback to full IFRSs*).
- 7 We acknowledge that the draft Q&A '*Application of the IFRS for SMEs for financial periods ending before the IFRS for SMEs was issued*' has been developed as the question included in the draft Q&A was raised by some constituents who did not think the IFRS for SMEs was clear. We are also aware that many entities, that are preparing, or are going to prepare financial statements in accordance with the IFRS for SMEs, have previously followed a regulation very different to the IFRS for SMEs or no regulation at all. The first years under the IFRS for SMEs will therefore be associated with a certain level of uncertainty, and we think questions will arise to which the answer will seem straightforward in a few years time when entities have been accustomed to the IFRS for SMEs. We believe the question included in the draft Q&A *Application of the IFRS for SMEs for financial periods ending before the IFRS for SMEs was issued* is of this nature.
- 8 It could be argued that it is helpful to issue many Q&As to facilitate the implementation of the IFRS for SMEs. However, by doing so entities will not become accustomed to the principle-based IFRS for SMEs where professional judgement needs to be applied, but to a more rule-oriented approach and standards with sizeable guidance. In our view this would be unfortunate. As further explained in paragraphs 12 - 14, we therefore believe that this is another reason not to issue the Q&A.
- 9 As will be further elaborated in paragraphs 15 - 20, we do not think the draft Q&A *Interpretation of 'undue cost or effort' and 'impracticable'* should be issued, as the biggest task in assessing 'undue cost or effort' is related to the professional judgement to be carried out and as the term 'impracticable' is also included in full IFRSs where it has not been considered a problem.
- 10 In addition, we think that there is no limit on the number of different types of possible deviations from the IFRS for SMEs the SMEIG may indirectly have committed itself to consider if it decides to issue the Q&As: *Departure from a principle in the IFRS for SMEs*; *Prescription of the format of financial statements by local regulation*; and *Jurisdiction requires fallback to full IFRSs*.
- 11 In case the SMEIG would decide to issue one or more of the draft Q&As in the third batch, our detailed comments below provide some additional input.

Application of the IFRS for SMEs for financial periods ending before the IFRS for SMEs was issued

View of EFRAG:

- EFRAG agrees with the answer provided in the draft Q&A; however, it does not think the Q&A should be issued.

- 12 The IFRS for SMEs does not prohibit an entity from applying the standard for periods ending before the IFRS for SMEs was issued. Accordingly, as long as an entity can comply with the requirements of the IFRS for SMEs, EFRAG considers that an entity is able to apply the standard also for periods ending before the standard was issued. EFRAG therefore agrees with the content of the draft Q&A.
- 13 We acknowledge that the IFRS for SMEs does not specifically address whether an entity can apply the IFRS for SMEs for financial periods ending before the standard was issued. It could therefore be argued that a Q&A is needed. However, we think the answer will be considered straightforward when preparers become more accustomed to the IFRS for SMEs, and we could be worried about the number of potential Q&As to be issued, should the Q&As provide an answer for all the circumstances that are not specifically addressed in the IFRS for SMEs. We therefore think the Q&A should not be issued.
- 14 In the future, when the IFRS for SMEs is amended, we think that it may be necessary to consider including guidance on what version of the standard should be considered when an entity chooses to apply the IFRS for SMEs for financial years ending before the latest amendments. However, this guidance should be included in the standard itself and not in Q&As.

Interpretation of ‘undue cost or effort’ and ‘impracticable’

View of EFRAG:

- Overall EFRAG agrees with the content of the draft Q&A; however, it does not think the benefits of the Q&A justify issuing the Q&A.

- 15 Except for the issues mentioned in paragraph 21 below, EFRAG generally agrees with the interpretation of ‘undue cost or effort’ and ‘impracticable’ included in the draft Q&A, but thinks that the guidance in the draft Q&A is not helpful.
- 16 ‘Impracticable’ is already defined in the IFRS for SMEs. What the draft Q&A adds is explaining that impracticable generally only covers a situation where information is unavailable.
- 17 Some guidance is provided on ‘undue cost or effort’. This term is, according to the draft Q&A, deliberately not defined in the IFRS for SMEs as it will depend on the SME’s specific circumstances and management’s professional judgement in assessing costs and benefits. The draft Q&A clarifies that where ‘undue cost or effort’ is used together with ‘impracticable’ this shall be applied in the same way as ‘undue cost or effort’ on its own.
- 18 While we agree with this, we note that the biggest task in assessing ‘undue cost or effort’ is related to the professional judgement to be carried out. Although the draft

Q&As clarifies what the judgement should be about, the most complicated part of assessing what 'undue cost or effort' means in the specific situation is still left to the preparer. However, we believe that it is probably not possible to make a more precise general description in a Q&A than what has been done. The answer can therefore only be derived from applying professional judgement, and not from issuing Q&As.

- 19 At the same time we are considering how much more costly it will be to prepare financial statements in accordance with the IFRS for SMEs if an entity, besides having to ensure compliance with the text of the standard itself, has to stay informed about the additional literature – including the Q&As. Even though the Q&As are meant as a help and are described as non-mandatory literature, every new Q&A adds to the amount of additional literature.
- 20 Because of these costs of issuing a Q&A and the limited guidance the Q&A can provide, EFRAG does not think the Q&A should be issued.
- 21 Should it be decided to issue the Q&A, EFRAG has the following comments:
- (a) The term 'impracticable' could according to the interpretation be interpreted as something that is objectively determinable and unrelated to the actual facts and circumstances. This interpretation could be formed as paragraph 3 of the Q&A states:
- 'Undue cost or effort' is deliberately not defined in the IFRS for SMEs as it will depend on the SME's specific circumstances and management's professional judgement.
- The sentence seems to imply that terms that are defined in the IFRS for SMEs, including 'impracticable', should not require judgement and assessment of the specific circumstances. We consider this to be doubtful.
- (b) The Basis for Conclusion should mention or refer to paragraphs 2.13 and 2.14 of the IFRS for SMEs. These paragraphs explain the balance between benefit and cost, and it seems to be on this concept 'undue cost or effort' hangs.
- (c) EFRAG has discussed whether it is appropriate to elaborate on the term 'impracticable' and 'undue cost or effort' in a Q&A to the IFRS for SMEs as the terms are also used in (full) IFRS or basis for conclusions to (full) IFRS. EFRAG thinks it is appropriate as the IFRS for SMEs should be considered as a separate stand-alone standard. Neither the IFRS for SMEs nor the accompanying guidance is therefore to be taken into consideration when interpreting (full) IFRS. In the same manner, and in accordance with paragraph 10.6 of the IFRS for SMEs, (full) IFRS should not (but could) be considered when applying the IFRS for SMEs. It therefore seems inappropriate that the Basis for Conclusions starts by stating how some people interpret full IFRS. In addition, this introduction is not very helpful as it does not state whether those 'some people' are right or wrong.
- (d) The IFRS for SMEs defines 'impracticable' as follows: 'Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so'. The draft Q&A states that therefore 'impracticable' generally only covers situations where information is unavailable. We think this could lead to the conclusion that 'impracticable' and 'after making every reasonable effort' is the same as 'impossible' and we do not consider this to be the case. We consider that 'impossible'

represents a higher hurdle than 'impracticable' and 'every reasonable effort'. We think this should be reflected in the answer provided.

Departure from a principle in the *IFRS for SMEs*

View of EFRAG:

- EFRAG overall agrees with the answer provided in the draft Q&A; however, it does not think the Q&A should be issued.

- 22 As noted above, EFRAG does not consider it necessary to issue a Q&A on this issue, and if a Q&A is issued it should be more general (see paragraphs 36 - 37). EFRAG does, however, overall agree with the answer provided in the draft Q&A.
- 23 According to paragraph 3.3 of the IFRS for SMEs, financial statements shall not be described as complying with the IFRS for SMEs unless they comply with all the requirements of the IFRS for SMEs. Therefore, if a set of financial statements deviates from the requirements of the IFRS for SMEs as one or more accounting principles have been used for the preparation that are not in accordance with the IFRS for SMEs, the financial statements shall not be described as complying with the IFRS for SMEs.
- 24 The IFRS for SMEs does not prohibit that the chosen accounting practice is compared with that required by the IFRS for SMEs. Therefore, an entity is allowed to include such a comparison in its financial statements (provided that this is allowed under the accounting practice the entity has chosen).
- 25 When this is said, EFRAG does not agree with the statement included in paragraph four of the draft Q&A. According to the paragraph, when a jurisdiction is modifying certain sections of the IFRS for SMEs, an entity complying with the local SME standard will not be able to also state compliance with the IFRS for SMEs unless the modification does not affect the entity. We do not agree with this statement as the amendment may not necessarily be in conflict with the IFRS for SMEs – for example if the local IFRS for SMEs version prescribes the format for the financial statements and these requirements meet the minimal basic formatting requirements in the IFRS for SMEs (see below).

Prescription of the format of financial statements by local regulation

View of EFRAG:

- EFRAG agrees with the answer provided in the draft Q&A; however, it does not think the Q&A should be issued.

- 26 As noted above, EFRAG does not consider it necessary to issue a Q&A on this issue, and if a Q&A is issued it should be more general (see paragraphs 36 - 37). EFRAG does, however, agree with the answer provided in the draft Q&A.
- 27 According to paragraph 3.3 of the IFRS for SMEs, financial statements shall not be described as complying with the IFRS for SMEs unless they comply with all the requirements of the IFRS for SMEs.

- 28 As long as the entity complies with the requirements of the IFRS for SMEs, it can choose to prepare financial statements in accordance with more prescriptive requirements and still comply with the IFRS for SMEs.
- 29 We therefore agree with the answer provided in the draft Q&A.
- 30 In order to clarify the answer, we think it could be useful to amend the last sentence of paragraph two. Instead of saying: “[t]herefore, provided the format prescribed by local law and regulation meets the minimal basic formatting requirements...”, we would suggest: “[t]herefore, provided the format prescribed by local law and regulation does not conflict with the minimal basic formatting requirements...”.

Jurisdiction requires fallback to full IFRSs

View of EFRAG:

- EFRAG does not completely agree with the answer provided in the draft Q&A and does not think the Q&A should be issued.
- 31 As noted above, EFRAG does not consider it necessary to issue a Q&A on this issue, and if a Q&A is issued it should be more general (see paragraphs 36 - 37 below). In addition, EFRAG does not fully agree with the draft Q&A as we think fallback to full IFRSs may in some circumstances conflict with paragraph 10.5 of the IFRS for SMEs.
- 32 According to paragraph 3.3 of the IFRS for SMEs, financial statements shall not be described as complying with the IFRS for SMEs, unless they comply with all the requirements of the IFRS for SMEs.
- 33 Paragraph 10.4 of the IFRS for SMEs includes the requirements related to issues not specifically addressed in the IFRS for SMEs. It states that in those cases an entity’s management shall use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable. It is explained in paragraph 10.5 that the entity, in making the judgement, shall refer to and consider the applicability of, the following sources in descending order:
- (a) the requirements and guidance in this IFRS dealing with similar and related issues, and
 - (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses, and the pervasive principles in Section 2.
- 34 As it appears, if full IFRS is to be used as a fall back, it should not only be in accordance with the pervasive principles in Section 2 of the IFRS for SMEs. It should first of all not conflict with the requirements and guidance in the IFRS for SMEs dealing with similar and related issues.
- 35 It could for example be discussed whether applying IAS 12 *Income Taxes* on specific income tax issues not specifically covered in the IFRS for SMEs would always result in a solution that is consistent with the broader guidelines in the IFRS for SMEs. However, our major concern is focused on the future - on cases where new IFRSs are issued, and these new IFRSs are based on other principles (not necessarily other concepts and pervasive principles as referred to in paragraph 10.4) than the older standards on which the IFRS for SMEs is based.

According to the wording of the draft Q&A, the specific guidance in the new IFRS could then be applied even when it is inconsistent with specific guidance provided in the IFRS for SMEs on related issues. We question whether this is in accordance with paragraph 10.5 (a) of the IFRS for SMEs.

Comments related to three of the draft Q&As

View of EFRAG:

- EFRAG thinks that the guidance included in the IFRS for SMEs that is related to the three draft Q&As dealing with departure from the standard is sufficiently clear. The three Q&As related to this guidance should therefore not be issued. However, if it is decided to issue further guidance on the issue, EFRAG thinks the three Q&As could be combined and included in a more general Q&A.

36 Three of the five draft Q&As issued:

- (a) Departure from one or more principles in the IFRS for SMEs;
- (b) Prescription of the format of financial statements by local regulation; and
- (c) Jurisdiction requires fallback to full IFRSs,

consider whether financial statements can be said to comply with the IFRS for SMEs if not all the requirements of the IFRS for SMEs are met. EFRAG thinks the answer appears clearly in paragraph 3.3 of the IFRS for SMEs: “Financial statements shall not be described as complying with the IFRS for SMEs unless they comply with all the requirements of this IFRS”. We therefore do not think the three Q&As should be issued.

37 Should it be decided to issue more guidance on the subject, EFRAG would suggest that only one general Q&A on compliance with the IFRS for SMEs is issued. It seems possible to include the messages contained in the three Q&As in a more general Q&A.