Federation of European Accountants
Fédération des Experts comptables Européens

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Ref.: ACC/HvD/TS-LF/ID

Dear Ms. Flores,

Re: FEE Comments on EFRAG's Draft Letter - Advice on compatibility of the IFRS for SMEs and the EU Accounting Directives

(1) FEE (the Federation of European Accountants) is pleased to comment on the EFRAG Draft Letter on Advice regarding compatibility of the IFRS for SMEs (International Financial Reporting Standards for Small and Medium-sized Entities) and the EU Accounting Directives (78/660/EC and 83/349/EEC) (the "Draft Advice Letter").

(2) The analysis carried out by EFRAG in its Draft Advice letter will provide valuable input in the context of the European Commission's review of EU Accounting Directives and wider policy considerations on the role of the IFRS for SMEs.

(3) Our comments are limited to the detailed requirements of the IFRS for SMEs that EFRAG has identified in its Draft Advice Letter as being incompatible or possibly incompatible with the EU Accounting Directives. We have not performed any additional work to identify additional potential incompatibilities.

(4) In accordance with the guidelines provided by the European Commission, the analysis carried out by EFRAG defines "incompatibility" to mean that an accounting treatment required by the IFRS for SMEs is not permitted under the EU Accounting Directives.

(5) In its analysis, EFRAG notes that this approach means that when the IFRS for SMEs includes options for the accounting treatment of a transaction, other event or condition, an "incompatibility" is considered to exist only if none of these options is permitted under the EU Accounting Directives. Accordingly, EFRAG does not consider circumstances when only some of the options included in the IFRS for SMEs could be in conflict with the EU Accounting Directives to be "incompatibilities". We agree that this represents a reasonable approach, but we question whether this approach has indeed been applied in all cases (see paragraph 11 below).

(6) We also agree with the approach used by EFRAG that where the EU Accounting Directives are “silent” on accounting treatments of transactions, events or conditions, no conflict is considered to arise.

(7) We note that EFRAG’s analysis has been performed with the assumption that inconsistencies between the EU Accounting Directives and the International Accounting Standards (IASs) in existence at 1 May 2002 were removed by the Directive 2003/51/EC of 18 June 2003 and that accordingly, EFRAG has not considered the requirements of the IFRS for SMEs that are the same as those in IAS at 1 May 2002. We agree with this approach.

(8) We also note that EFRAG decides not to consider whether the option to follow the requirements of IAS 39 would result in incompatibilities with the EU Accounting Directives. In the absence of this analysis, we wonder whether an entity that used this option would avoid the incompatibility noted by EFRAG.

(9) While some incompatibilities may be expected to arise only infrequently (e.g. the incompatibility with respect to amortisation of goodwill will arise only if the useful life of goodwill cannot be estimated reliably), we note that EFRAG has decided to remain factual and has not attempted to assess the importance of the incompatibilities. We agree with this approach.

(10) Except for points 3 and 4 in EFRAG’s covering letter, as detailed below, we agree with EFRAG’s main conclusions regarding the requirements of the IFRS for SMEs that have been identified as incompatible with the EU Accounting Directives.

(11) As detailed in paragraphs 16 to 22 below, we query the conclusions reached by EFRAG regarding the measurement requirements of associates and investments in jointly controlled entities. Our understanding is that the IFRS for SMEs includes an option to use the equity method to account for such investments in paragraphs 14.4 and 15.9. Accordingly, on the basis of the assumption that there is only an incompatibility if none of the options for a requirement in the IFRS for SMEs is permitted under the EU Accounting Directives, we do not think that there is an incompatibility in this case.

(12) Our detailed comments on the Basis for Conclusion for EFRAG’s advice in addition to our responses to the questions to constituents are included as an Appendix to this letter.

For further information on this letter, please contact Leyre Fuertes, Project Manager.

Yours sincerely,

Hans van Damme

President

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Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

Requirements of the IFRS for SMEs assessed to be incompatible with the EU Accounting Directives

Extraordinary items

(13) We agree with EFRAG's conclusion that as the IFRS for SMEs specifically prohibits items to be presented or described as "extraordinary items" and the Fourth EU Accounting Directive specifically requires certain items to be presented under "Extraordinary income and extraordinary charges", the requirement of the related paragraph 5.10 of the IFRS for SMEs is incompatible with the Accounting Directives.

Financial instruments at fair value

(14) We agree with EFRAG's conclusion that as some financial instruments (in particular financial liabilities) should be measured at fair value according to the IFRS for SMEs and some of these instruments cannot be measured at fair value according to the EU Accounting Directives, the requirements of paragraphs 12.7, 12.8 of the IFRS for SMEs and related references are not compatible with the EU Accounting Directives.

(15) We also note that EFRAG decides not to consider whether the option to follow the requirements of IAS 39 would result in incompatibilities with the EU Accounting Directives. In the absence of this analysis, we wonder whether an entity that used this option would avoid the incompatibility noted.

Measurement of investments in associates and joint ventures for which there is a published price quotation at fair value in "non-separate financial statements"

<u>Consolidated financial statements and "non-separate financial statements"</u>

(16) In relation to the measurement of associates and joint controlled entities in the consolidated financial statements and in non-separate financial statements, we are not convinced with EFRAG's conclusions that there is an "incompatibility" between the IFRS for SMEs and the EU Accounting Directives for the reasons explained below.

(17) Our understanding is that the IFRS for SMEs includes an option to use the equity method in consolidated statements:

- for the measurement of all the investments in associates in the consolidated financial statements, paragraph 14.4 of the IFRS for SMEs indicates that an accounting policy election can be made between the cost model, the equity method and the fair value model. This means that the requirement of 14.7 to measure investments in associates for which there is a published price quotation at fair value does not apply to the entities that have opted to use the equity method. The disclosure requirement in paragraph 14.12(c) supports the view that the equity method may be used also for investments in associates for which there is a published price quotation.

- for the measurement of all the interests in jointly controlled entities in the consolidated financial statements, paragraph 15.9 of the IFRS for SMEs similarly indicates that an accounting policy election can be made between the cost model, the equity method and the fair value model.

- Hence there is no incompatibility between the IFRS for SMEs and the Seventh EU Directive in the consolidated financial statements.

(18) For the measurement of investments in associates and interests in jointly controlled entities in the consolidated financial statements, the Seventh EU Directive requires the equity method (or, in the case of the jointly controlled entities, also allows proportional consolidation).

<u>Non-separate financial statements are not dealt with by the EU Accounting Directives</u>

(19) In our opinion, there is no incompatibility on the issue of the treatment of associates and joint ventures in "non-separate financial statements". This is because such accounts are not dealt with by the EU Accounting Directives. The Seventh EU Accounting Directive is addressed to parent companies (Art. 1). Parents are companies with a consolidated subsidiary (Art. 1), and they do not include companies that have only associates or joint ventures. Therefore, the Seventh EU Accounting Directive does not deal with "non-separate financial statements". The Fourth EU Accounting Directive concerns separate accounts.

(20) Even if this line of argument is not accepted, we still think that there is no incompatibility between the IFRS for SMEs and the EU Accounting Directives for the reasons explained below.

(21) If non-separate financial statements (i.e. the financial statements of an entity which owns only associates and/or investments in jointly control entities and which are not separate financial statements) were considered to fall within the scope of the Seventh EU Accounting Directive, the equity method would also apply to the non-separate financial statements. If, instead, the measurement of investments in associates and interests in jointly controlled entities in the non-separate financial statements is considered to fall within the Fourth EU Accounting Directive, we understand that paragraph 59 of that Directive would permit the use of the equity method.

(22) As noted by EFRAG and detailed in paragraph 5 of this letter, an "incompatibility" is considered to exist only if none of the options on a particular topic in the IFRS for SMEs is permitted under the EU Accounting Directives. Given that the IFRS for SMEs allows the equity method whereas the EU Accounting Directives would require or permit use of that method, we do not think that there is an incompatibility in the above cases.

Amortisation of goodwill over ten years when an entity is unable to make a reliable estimate of the useful life

(23) We agree with EFRAG's conclusion that as the IFRS for SMEs deems the useful life of goodwill to be ten years if an entity is unable to make a reliable estimate of its useful life and the Fourth EU Accounting Directive would require goodwill to be written off in five years unless a longer useful life can be supported, the requirements of the related paragraph 19.23a of the IFRS for SMEs is not compatible with the EU Accounting Directives.

Immediate recognition in profit or loss of negative goodwill not related to realised gain

(24) We agree with EFRAG's conclusion that as the IFRS for SMEs always requires immediate recognition in profit or loss of negative goodwill whereas the EU Accounting Directives only permits immediate recognition of negative goodwill in profit or loss in some instances, the related paragraph 19.24 of the IFRS for SMEs is not compatible with the EU Accounting Directives.

Reversal of goodwill impairment losses

(25) The IFRS for SMEs specifically prohibits reversal of goodwill impairment, while the Fourth EU Accounting Directive specifically requires impairment losses of fixed assets to be reversed if the reasons for which they have been recognised have ceased to apply. If it is assumed that goodwill is a fixed asset in terms of art. 35 of the Fourth Directive, the requirements of the related paragraph 27.28 of the IFRS for SMEs is not compatible with the EU Accounting Directives. However, some argue, that this argument is not relevant for goodwill, because goodwill is not an identifiable good in the form of tangible items, rights and other economic benefits, that are independently realisable.

Questions to constituents

Paragraphs of the IFRS for SMEs that are not incompatible with the EU Accounting Directives

Q1	Do you think that some of the paragraphs of the IFRS for SMEs, EFRAG has identified as being incompatible with the EU Accounting Directives, are compatible with the EU Accounting Directives? (If so, why?)

(26) In relation to the measurement of associates and jointly controlled entities in the consolidated financial statements and in "non-separate financial statements", we are not convinced with EFRAG's conclusions that there is an "incompatibility" between the IFRS for SMEs and the EU Accounting Directives for the reasons set out in paragraphs 16 to 22 above.

Appendix - Our comments on the Basis for Conclusion for EFRAG's advice on compatibility of the IFRS for SMEs and the EU Accounting Directives including our responses to the questions to constituents

Paragraphs of the IFRS for SMEs that may be incompatible with the EU Accounting Directives

Q2	Do you think that paragraphs 9.6, 19.14, 21.4 and/or 29.24 are incompatible with the EU Accounting Directives? (If so, which and why?)

Potential voting rights

(27) We note, like EFRAG, that the EU Accounting Directives are silent on whether entities are allowed to take options and convertible instruments into account when determining whether or not to include an entity in the consolidation. In addition, we note, like EFRAG, that the EU Accounting Directives use the word "right" where control is discussed. In our view, whether options and convertible instruments can be taken into account under the EU Accounting Directives is a matter of interpretation and judgement has to be exercised. For this reason, we do not think that there is a clear incompatibility in this context.

"Less likely than not" liabilities

(28) We note that according to paragraph 21.4 of the IFRS for SMEs one of the criteria for recognition of a provision is that it is "probable (i.e. more likely than not)" that the entity will be required to transfer economic benefits to settle the obligation. We acknowledge that Article 20.1 of the Fourth EU Accounting Directive uses the terms "likely to be incurred" or "certain to be incurred but uncertain as to amount or as to the date on which they will arise" as requirements related to recognition of provisions. In our view, it is at least acceptable to interpret the term "likely" in the Directive in the sense of "probable" (i.e. more likely than not) as in the IFRS for SMEs. For this reason, we do not think that there is a clear incompatibility in this context.

(29) We also note the following drafting points regarding the section "less likely than not liabilities" of EFRAG's Draft Letter:

- The section deals with potential incompatibilities between the recognition requirements for provisions and liabilities in the IFRS for SMEs and in the Fourth Accounting Directive. Therefore, we suggest that all references to measurement rules for provisions, liabilities and taxes be deleted (paragraph 29.24 of the IFRS for SMEs, "probability-weighted average amount" etc.);

- The section deals with general recognition requirements. For business combinations, special recognition requirements apply. We do not believe that these exceptions create incompatibilities regarding general recognition requirements. Therefore, we suggest that all references to recognition requirements in a business combination be deleted.

Paragraphs of the IFRS for SMEs that are incompatible with the EU Accounting Directives

Q3	Do you think there are other paragraphs of the IFRS for SMEs that are incompatible with the Council Directives? (If so, why?)

(30) Our comments are limited to the detailed requirements of the IFRS for SMEs that EFRAG has included in its Draft Advice Letter as being incompatible with the EU Accounting Directives. We have not carried out supplementary work or performed a detailed assessment to identify any other potential incompatibilities.

Different language versions of the EU Accounting Directives

Q4	Are you aware of situations where the conclusions reached by EFRAG would have been different had another language version than the English version been applied in the analysis? (If so, what conclusion would be different and why?)

(31) We are not aware of such situations.

Other issues

Q5	Do you have other comments in relation to EFRAG's conclusions and their bases (including conclusions stated in EFRAG's working paper)?

(32) We have no other comments at this stage.