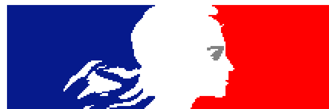

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RÉPUBLIQUE FRANÇAISE

Conseil National de la Comptabilité

3, Boulevard Diderot
75572 PARIS CEDEX 12

Phone **33 1 53 44 52 01**

Fax **33 1 53 18 99 43/33 1 53 44 52 33**

Internet http://www.cnc.minefi.gouv.fr

Mel jean-francois.lepetit@cnc.finances.gouv.fr

Chairman

JFL

n° 592

Paris, the 4th october 2007

Paul PACTER
Project Director
International Accounting Standards Board
30, Cannon Street
London ECAM 6XH
UNITED KINGDOM

Re: ED IFRS for SMEs

Dear Paul,

On behalf of the Conseil national de la comptabilité (CNC), I am writing to comment on the Exposure Draft IFRS for Small and Medium-sized Entities (ED). This letter is submitted in CNC's capacity of contributing to the IASB's due process. In the second and third parts to this letter, we provide detailed comments and proposals in response to the invitation for comments. Our comments and proposals are derived from our key observations, as described below.

The CNC acknowledges the modifications made to the draft IFRS/PME as compared to the pre-exposure draft initially published in 2006 in order to simplify the standard and make it more self-contained. However, taking into account the needs of the relevant users, further improvements are required in order to draw up a full set of principles covering all transactions carried out by SMEs. Moreover, the exact scope definition should be left to local or regional jurisdictions.

1 – Scope definition left to local or regional jurisdictions

The IASB intends IFRSs for SMEs to apply to « not publicly accountable » (NPA) entities, i.e. non listed entities and to those entities, which do not hold assets in a fiduciary capacity for a large group of third parties. (Paragraph 1.2).

Criteria other than financial structure, such as size, membership of a listed group, shareholding by financial investors, may be used for the scope definition. However, the CNC considers that the scope definition is a prerogative of national or regional jurisdictions and not of the IASB. Instead, IASB could provide guidance to help jurisdictions to determine which standards could be applied to whom.

The objectives of financial statements which are «*to provide information on the financial situation, performance and cash flows of an entity*» (paragraph P7 of the Preface), do not take into account tax matters in individual states which may be very diversified. Nevertheless, for individuals financials statements purposes, it is not possible to ignore local legislation, and rules such as those relating to the legal rights of ownership, prevention of entities' financial difficulties, creditors' guarantees, distribution of dividends. It therefore appears important that member states should have the right to decide on the scope of application, as they are in the best position to deal with legal and fiscal constraints.

The general objective of the IFRS is to provide SME with a set of simplified reporting principles enabling them to produce financial statements consistent with International Financial Reporting Standards. In any event, the name of the set of standards should be consistent with its contents. It is not possible to use the title "IFRS for SME" if that title is not consistent with the scope definition (excludes listed entities). If the title continues to raise problems, because for example the scope depends on each jurisdiction, it would be preferable to opt for a title such as "Simplified IFRSs" which is more in line with the overall objective of the standard.

2 – The same users but with different needs

The IASB makes no distinction between the users of IFRS financial statements in general and the users of IFRS financial statements for SME in particular. The CNC agrees that the external users, shareholders and creditors are the same. However, the needs of the SME users are considered to be different to those of listed companies because they rely on a long term operating perspective. This is why the CNC is in favour of measurement principles which contribute to long term valuation of SME.

Moreover, in the CNC's opinion, the needs of the manager, who often holds a significant interest in the entity, should also be taken into account as a user of the SME's financial statements. From a cost/benefit viewpoint, as well as on grounds of reliability, it is necessary to have same accounting principle for management accounts and for external reporting for third parties.

Even if the financial statements compliant with IFRS for SME are not intended to satisfy all the requirements of management who may, for example, have extra needs for internal management or tax purposes, they must constitute a common accounting base.

3 – Make the IFRS for SMEs more self-contained (see answer question 1)

IFRS for SMEs must be fully self-contained including the update procedure. The CNC considers that simplification is a more important objective than keeping IFRSs for SMEs in agreement with full IFRSs. Indeed, where a divergence in the IFRS for SMEs represents a genuine simplification, it should be preferred.

To make the standard self-contained, references to IAS or IFRS should be removed (see list in Appendix 1). The standard should indicate explicitly the accounting treatment for all the transactions relevant to SMEs. To make this point clear we refer to the treatment of options. If two options are available to SMEs, the standard should not just present the simplified or the most common option, and refer to the IAS or IFRS that deals with the more complex option. All the options made available to SMEs should be fully described in the body of the standard.

A clarification of the hierarchy set out in paragraphs 10.3 and 10.4 would reinforce the independent status of the standard for SMEs. If a framework is to be established for SMEs, it should not take the form of a section "Concepts and general principles" on the same level as other sections, but should head up all of the sections. In order to make a judgement management should be able to refer clearly to the following hierarchy :

- Requirements and explanations of IFRS for SMEs;
- Definitions, recognition and measurement criteria in the framework for SMEs;
- And on a non-mandatory basis, to full IFRSs, to the official pronouncements of other standard-setting bodies or accounting literature or recognised industrial practice to the extent that this does not conflict with IFRS for SMEs.

Lastly, independent status relies on a clear definition of all accounting treatment covered by IFRSs and related interpretations. Accordingly, it is essential that IFRSs for SMEs clarify whether IFRIC interpretations are included after adaptation to SMEs environment or whether they are explicitly excluded.

4 – An independent update process (see answer question 11)

To guarantee the independence of IFRS for SMEs, the IASB should initiate an appropriate update process. In general, the CNC stresses that SMEs with few resources require a stable set of standards. As a consequence, only stabilised definitions, recognition and measurement criteria must be introduced into IFRS for SMEs. Concepts still under discussion at the IASB or recently adopted by IASB, such as « SORIE » (see remarks on sections 3 to 8), contingent liabilities (see remarks on section 18), or projects under examination for deferred taxes (see remarks on section 28) and minority interest acquisitions (see remarks on section 9), cannot be included in the standard. Independence also implies that changes in "Full IFRS" or the issue of an interpretation by the IFRIC do not automatically impact IFRS for SMEs. A specific update process and an appropriate timetable must be put in place.

With regard to the update process, the CNC would like IASB /IFRIC to dedicate staff to the development and interpretation of sections of the standard, in order to have the means of applying what is proposed in the exposure draft, i.e. a distinct process for exposure drafts and interpretations.

5 – Comprehension of the standard

The simplification of IFRS for SMEs does not just rely on the reduction of the number of pages and the thickness of the volume. If the IFRS for SMEs is to be a “stand alone” document, it should be understandable and readable without preparers having to refer to the “Bound Volume IFRS” in order to draw up the financial statements. Certain sections should be completed, by including definitions instead of putting them in the glossary, as well as inserting additional guidance and explanations (see question 4), and illustrative examples adapted to SMEs.

Lastly it should be noted that the literal translation of the standard is not readily understandable for preparers and users unless they are already initiated in the application of international standards in the consolidated financial statements of listed groups. It is necessary to find a way to adapt, and not only translate, the standard in different languages in order to be fully explicit to SME which do not necessarily read plain English.

6 – Consider other simplifications of recognition and measurement principles

Considering the size of the target entity, an SME with a staff of 50, additional simplifications in recognition and measurement requirements should be introduced to avoid an excessive administrative load and maintain a favourable cost/benefit ratio. Simplifications are vital in key areas such as business combinations (amortisation or depreciation option for goodwill, non recognition of contingent assets and liabilities), recognition of financial assets and liabilities and hedging, leasing contracts, income from ordinary activities.

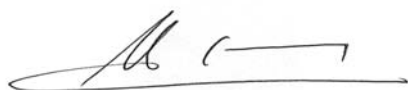
Other less important subjects can be simplified, for example the criteria for classifying elements of current and non current assets and liabilities (see comments on sections 3 to 8), or the reassessment of the residual value and useful life of intangible assets only when there is a variation in internal or external indicators (see comments on section 17) and not annually.

Our detailed comments and proposals on how to achieve the above objectives are provided in the various attachments to this letter:

- Attachment 1: Responses to the invitation to comment;
- Attachment 2: Detailed comments by section in addition to the comments to the specific questions;
- Appendix 1: References to IAS or IFRS.

If you would like further clarification of the points raised in this letter, I would be happy to discuss these further with you.

Yours sincerely.



Jean-François Lepetit

Chairman of CNC

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Attachment 1: Responses to the invitation to comment

Question 1 - Stand-alone document

In deciding on the content of the proposed IFRS for SMEs, the IASB focused on the types of transactions and other events and conditions typically encountered by SMEs with about 50 employees. For such entities, the proposed IFRS is intended to be a stand-alone document, with minimal cross-references to full IFRSs.

With the objective of a stand-alone document in mind, are there additional transactions, other events or conditions that should be covered in the proposed standard to make it more self-contained? Conversely, is there guidance in the draft standard that should be removed because it is unlikely to be relevant to typical SMEs with about 50 employees?

The CNC agrees that the IFRS for SMEs should be a stand alone document but, as stated in the covering letter (point 3), does not consider that this objective has been fully achieved. As stated, in order to achieve this objective it is necessary to:

- remove all references to IAS or IFRSs;
- develop IAS or IFRS principles adapted to the SME environment.

In spite of the numerous references to IAS or IFRS, certain transactions which are common in SME are not dealt with in the IFRS.

Additional transactions and other events which should be covered by the proposed standard

Operations under common control

Section 18 “Business combinations and goodwill” excludes business combinations involving entities under common control and these transactions are not dealt with by another section of the IFRS for SMEs. However, Such transactions are rather common for SMEs. Therefore, the CNC believe that the accounting treatment for these transactions should be defined explicitly (see comments on section 18).

Reverse acquisitions

The IFRS for SMEs, unlike IFRS 3, does not stipulate the accounting treatment of reverse acquisitions. This lack of guidance may make it necessary for SMEs to refer to IFRS 3 or to other sets of standards, in order to determine the relevant accounting treatment if they are involved in such transactions. Even if this type of transaction is not widespread or systematic, it is sufficiently frequent to justify including the complete accounting treatment for both individual and consolidated accounts in the IFRS for SMEs without requiring reference to IFRS 3 (see remarks on section 18).

Discounting

The standard adopts the principle of discounting in different sections (financial and non-financial assets and liabilities, leasing contracts, etc.). The CNC considers that the issue of discounting must be dealt with in a separate section with guidance and example.

Financial assets and liabilities (see remarks on section 11)

- Derivatives

To make it easier to understand this section on financial assets and liabilities, the concept of derivatives should be introduced including indications on initial and subsequent recognition. The section could then be more explicit if it details separately the accounting treatment of:

  - Non derivative financial assets
  - Non derivative financial liabilities
  - Derivatives
  - Hedging

- Commodity contracts

The CNC considers that the paragraphs dealing with purchase and sale contracts for non-financial items especially commodity contracts require further development, as the requirements of paragraphs 11.4 and 11.5 are insufficiently detailed.

Because of the specific nature of this subject, the CNC suggests creating a separate chapter of specialised activities for commodities contracts. This chapter could then deal with the distinction between financial instruments and "own use" contracts and give specific guidance on inventories and revenue recognition for brokers, dealers or trading activities.

- Insurance contracts

With regard to insurance, contracts subscribed should be dealt with in the IFRS for SMEs even if the full IFRSs have not yet dealt with this subject. Specific requirements should be set out in a chapter dealing with recognition of premiums paid and claims received. This would also enable a better differentiation between insurance contracts and investments.

- Hedging instruments : purchase of simple options

The CNC thinks that the purchase of "simple" options should be able to qualify as a hedging instrument. Details could be given of the types of option qualifying for hedge accounting: non leveraged option and option without sales of options included in. For example, caps, floors and tunnels should be able to qualify as hedging instruments for the interest rates of financial liabilities.

Financial reporting in hyperinflationary economies

The CNC considers section 29 unsatisfactory because it is only a summary of IAS 29. The summary would be insufficient for entities directly concerned by this standard. The CNC therefore suggests that the standard should be included in its entirety at the end of the exposure draft with the sections concerning special cases (see remarks on section 29).

Guidance which should be removed

Discontinued operations

Section 36 deals with assets held for sale and discontinued operations.

Discontinued operations are rare in SMEs because entities with a staff of 50 generally only have one activity. As a simplification, we suggest that no specific treatment of these operations be required (see remarks on section 36).

The treatment of assets held for sale should be included in the relevant individual sections (see remarks on section 36).

Financial assets and liabilities (see comments on section 11).

- Disposals of guarantee instruments

With respect to the requirements of paragraph 11.26 which deals with the recognition of guarantee instruments by the transferor and transferee, the CNC considers it unlikely that SMEs would be transferees in this type of transaction and therefore suggests that the requirements of this paragraph be limited to the case of the transferor.

- Perpetual debt

Paragraph 11.11 (e) stipulates that perpetual debts should be measured at fair value because they have no maturity date .The CNC believes that SMEs do not issue this kind of instrument and that therefore the example should be removed.

- Depreciation of financial commitments

The CNC recommends the elimination of paragraph 11.7(b) with respect to credit commitments given in paragraph 11.22 on depreciation, because in general SMEs cannot make such financial commitments.

Question 2 - Recognition and measurement simplifications that the Board adopted

The draft IFRS for SMEs was developed by:

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

(b) considering the modifications that are appropriate in the light of users' needs and cost-benefit considerations.

Paragraphs BC70–BC93 of the Basis for Conclusions describe the simplifications of recognition and measurement principles contained in full IFRSs that have been made in the proposed IFRS for SMEs and explain the Board's reasoning.

Are there other recognition or measurement simplifications that the Board should consider? In responding, please indicate:

(a) the specific transactions, other events or conditions that create a specific recognition or measurement problem for SMEs under IFRSs;

(b) why it is a problem; and

(c) how that problem might be solved.

Classification of finance leases

Section 19 proposes a classification distinguishing finance from operating leases, according to their qualitative characteristics. Additionally, the CNC suggests, as a simplification, introducing a numerical threshold for finance leases.

Measurement of leased assets

Section 19 stipulates that assets recognised by the lessee under a leasing contract (paragraph 19.8), shall be measured at the fair value of the leased property at the inception of the lease.

This concept is complex for SMEs and the CNC suggests that it could be clarified.

In most cases, the fair value of the contract is equal to the discounted amount of total lease payments plus the price of the purchase option.

The CNC recommends completing paragraph 19.8 with an indication that the fair value at the inception of the lease is presumed to be equal to the discounted amount of total lease payments plus the price of the purchase option (see comments on section 19).

Acquisition and disposal of minority interests

As a simplification, variations of minority interests should be treated as transactions with third parties and would affect either the income statement (disposals) or goodwill (acquisitions i.e. additional acquisitions of shares would not modify the measurement of identified assets and liabilities, determined at the date control is obtained, the total difference being transferred to goodwill) (see comments on section 9). CNC disagrees with the introduction of the accounting principle of revised IAS 27 as this standard.

Non-current assets held for sale

Section 36 (see comments) stipulates that non-current assets held for sale shall be classified separately and measured at the lower of their carrying amount and fair value less costs to sell. The most important information for the users of financial statements of SMEs is the correct valuation of the asset to be sold. The decision to sell is an indication of possible decrease in value which justifies an impairment test. Ceasing amortisation is not a simplification.

As a simplification, it is suggested that non-current assets could be reclassified but without changing the valuation base applicable prior to the decision to sell especially, amortisation could continue until effective disposal. (see comments on section 36).

In addition, we recommend excluding from consolidation, investment in an entity acquired for short-term resale, i.e. within a period of 12 months. In this case, the investment in the acquired would be recognised as a financial asset in the balance sheet of the parent company (see comments on section 9).

Financial assets and liabilities (see comments on section 11)

The CNC welcomes the work performed to simplify the accounting treatment of financial instrument and especially:

- The elimination of the accounting treatment of embedded derivatives, financial instruments including separable embedded derivatives being measured at fair value through profit or loss.
- The use of two categories for financial assets and the elimination of assets held to maturity and assets held for sale.
- Restrictive requirements to derecognise financial assets and liabilities.

Nevertheless, the CNC considers that IFRS for SMEs must not lead to some instrument being fair valued when they are accounted for at amortised cost in full IFRS. For instance, special attention must be paid to variable interest rate liability with a cap and a floor included.

Moreover, more simplification are needed to provide an accounting treatment appropriate for SMEs.

Organisation of the section and scope

In order to facilitate the application of the standard, the CNC considers that:

- All definitions must be included in the section and detailed illustrative examples and guidance must be provided.
- Purchase and sale contracts for commodities and insurance contracts must be included in specific chapters.
- Leasing or insurance of a non-financial asset should not be dealt with in section 11.

Subsequent measurement of financial assets and financial liabilities

The CNC suggests that fair value should be the principle for subsequent measurement of financial assets except for loans and receivables and financial assets whose fair value can not be measured reliably for which amortised cost or cost is the accounting rule. On the contrary, for non derivative financial liability, amortised cost should be the rule with fair value being an exception in some specific situations (mainly for financial liabilities with embedded derivatives).

Hedge accounting

The CNC considers that simplifications should be introduced for hedge accounting (interest rate, currency, and price risks), without changing the basic principles:

- CNC suggests that derivatives should be defined in order to specify their accounting treatment. Moreover the CNC considers that the following exceptions should be introduced in order to facilitate hedge accounting: separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the change in intrinsic value of an option and excluding change in its time value and separating the interest element and the spot price of a forward contract.
- a "short cut method" should be introduced with a presumed efficiency of 100% for the limited list of hedging instruments dealt with by the exposure draft, although purchases of options should be added to this list as recommended by the CNC;
- introduction of the « basis adjustment » i.e. the measurement of the effects of hedging in the acquisition costs of non-financial assets, mainly fixed assets and stock ;
- possibility of using "simple" options as hedging instruments, without having to apply all the requirements of IAS 39 ;
- where the "short-cut method" is not applied, presentation of guidance for the tests of hedging efficiency (calculation and measurement methods, limits, accounting consequences) ;
- requirements dealing with the cases of discontinuance of the hedging relationships.

Share-based payments (see comments on section 25)

The CNC considers the reference to IFRS 2 inappropriate, since the latter standard is mainly intended for listed entities. The simplifications are therefore considered unsatisfactory.

The CNC agrees with the recognition and measurement principles for "cash settled" contracts set out in the exposure draft. On the other hand, the CNC considers that equity settled transaction should be measured at intrinsic value at inception with no subsequent re-measurement.

In addition, the CNC recommends that further information and guidance should be provided in respect of the treatment of repurchase commitments given by an entity or its shareholders in order to maintain the liquidity of schemes in an unlisted entity environment.

Question 3 - Recognition and measurement simplifications that the Board considered but did not adopt

Paragraphs BC94–BC107 identify some recognition and measurement simplifications that the Board considered but decided not to adopt, for the reasons noted.

Should the Board reconsider any of those and, if so, why?

BC 98 Treat all staff benefit schemes as defined contribution schemes

The CNC agrees with the proposal in the exposure draft of IFRS for SMEs to provide for post employment benefits and pensions. The CNC thinks that the simplification considered by the

Board and abandoned, to treat all employees benefit schemes as defined contribution schemes, should not be reconsidered.

BC 101 Non recognition of share-based payments

The CNC is in favour of recognising share-based payments as an expense, as proposed in the exposure draft, even if the valuation methods should be adapted to an SME environment. The CNC thinks that the simplification considered but not adopted by the Board, of not recognising share-based payments should not be re-examined.

BC 102 Non recognition of deferred taxes

Accounting for deferred taxes in the consolidated financial statements causes no particular difficulties. However, the CNC is uncertain about how the requirements of section 28 « Income Taxes » apply to an entity's individual financial statements because there are no specific adaptations in that respect (see comments on section 28).

Question 4 - Whether all accounting policy options in full IFRSs should be available to SMEs

The draft IFRS for SMEs proposes that accounting policy options available under full IFRSs should generally also be available to SMEs. As explained more fully in paragraphs BC108–BC115 of the Basis for Conclusions, the Board concluded that prohibiting SMEs from using an accounting policy option that is available to entities using full IFRSs could hinder comparability between SMEs and entities following full IFRSs. At the same time, the Board recognised that most SMEs are likely to prefer the simpler option in the proposed IFRS for SMEs. Therefore, the Board concluded that in six circumstances in which full IFRSs allow accounting policy options, the IFRS for SMEs should include only the simpler option, and the other (more complex) option(s) should be available to SMEs by cross-reference to the full IFRSs.

Do you agree with the Board's conclusions on which options are the most appropriate for SMEs? If not, which one(s) would you change, and why?

Should any of these options that would be available to SMEs by cross-reference to the full IFRSs be eliminated from the draft IFRS for SMEs and, if so, why?

Because IFRS for SMEs have world-wide application, the CNC believes that there should be as many accounting options available as possible in order to satisfy the needs of preparers and users of different cultures.

However, the Board's approach is not a move towards the proclaimed objective of producing a self-contained standard. Indeed, in order to favour the simplest solution the Board has chosen not to set out in full the options considered to be unfavourable or complex in the standard, but instead to provide a reference to the relevant IFRS or IAS.

The accounting treatment (see list in Appendix 1), relating to options and other special requirements, for which the IFRS for SMEs is cross-referenced to the relevant IAS or IFRS (see point 3 of covering letter and question 1) should be set out in full and adapted in the individual sections of the SME standard.

Question 5 - Borrowing costs

IAS 23 *Borrowing Costs* currently allows entities to choose either the expense model or the capitalisation model to account for all of their borrowing costs. In May 2006 the IASB published an Exposure Draft proposing to amend IAS 23 to prohibit the expense model and to require the capitalisation model. Section 24 *Borrowing Costs* of the draft IFRS for SMEs proposes to allow SMEs to choose either the expense model or the capitalisation model.

Do you agree or disagree with the proposal to allow SMEs to choose either the expense model or the capitalisation model for borrowing costs, and why?

The CNC is in favour of allowing SMEs to choose either the expense or the capitalisation model. The expense model is without question the most simple for SMEs to apply and must therefore be maintained in a standard intended for small entities. Nevertheless, the capitalisation model should be available to meet the needs of certain SMEs, such as for valuing stock in activities with a long production cycle.

Question 6 - Topics not addressed in the proposed IFRS for SMEs

Some topics addressed in full IFRSs are omitted from the draft IFRS for SMEs because the Board believes that typical SMEs are not likely to encounter such transactions or conditions. These are discussed in paragraphs BC57–BC65 of the Basis for Conclusions. By a cross-reference, the draft standard requires SMEs that have such transactions to follow the relevant full IFRS.

Should any additional topics be omitted from the IFRS for SMEs and replaced by a cross-reference? If so, which ones and why?

See comments on question 1.

Question 7 - General referral to full IFRSs

As noted in Question 1, the IFRS for SMEs is intended to be a stand-alone document for typical SMEs. It contains cross-references to particular full IFRSs in specific circumstances, including the accounting policy options referred to in Question 4 and the omitted topics referred to in Question 6. For other transactions, events or conditions not specifically addressed in the IFRS for SMEs, paragraphs 10.2–10.4 propose requirements for how the management of SMEs should decide on the appropriate accounting. Under those paragraphs, it is not mandatory for SMEs to look to full IFRSs for guidance.

Are the requirements in paragraphs 10.2–10.4, coupled with the explicit cross-references to particular IFRSs in specific circumstances, appropriate? Why or why not?

As indicated in the covering letter (point 3), the CNC supports a self-contained standard. The proposed hierarchy set out in paragraphs 10.3 and 10.4 of the exposure draft aims at meeting this objective. Nevertheless the stand-alone status of the standard should be strengthened by:

- removing references to IAS and IFRS and setting out the principles and guidance in full in the IFRS for SMEs ;
- the introduction of a specific conceptual framework for SMEs as the leading section rather than a section amongst others ;
- the creation of teams dedicated to drawing up and updating the sections of the IFRS for SMEs at the IASB and the IFRIC (see point 4 of covering letter).

Question 8 - Adequacy of guidance

The draft IFRS for SMEs is accompanied by some implementation guidance, most notably a complete set of illustrative financial statements and a disclosure checklist. A sizeable amount of guidance that is in full IFRSs is not included. Accordingly, additional guidance especially tailored to the needs of SMEs applying the proposed IFRS may be required.

Are there specific areas for which SMEs are likely to need additional guidance? What are they, and why?

The CNC would like the implementation guidance to be more complete. As this standard is for SMEs it should have an educational approach. Further implementation guidance is

required in the form of additional examples of financial statements. The CNC notes that the Statement of Changes in Equity mentioned in section 6 and the Cash Flow Statement drawn up under the direct method as stipulated in section 7, are not illustrated in the exposure draft and models should be provided.

Additionally, further examples adapted to the everyday operations of SMEs should be provided. SMEs have limited administrative resources as compared to full IFRS compliant entities. To make the best use of IFRS for SMEs, they require more information of a pedagogical nature, to enable them to understand readily the implications of events encountered by the SME for their financial statements.

Question 9 - Adequacy of disclosures

Each section of the draft IFRS for SMEs includes disclosure requirements. Those requirements are summarised in the disclosure checklist that is part of the draft implementation guidance *Illustrative Financial Statements and Disclosure Checklist*.

Are there disclosures that are not proposed that the Board should require for SMEs? If so, which ones and why? Conversely, do you believe that any of the proposed disclosures should not be required for SMEs? If so, which ones and why?

Statements of variation

The standard requires the statements of variation to provide information for two accounting periods so that, in effect, it is necessary to treat information for three periods. The CNC considers that this treatment could be limited to the reference period (position at the beginning and the end of the period). The statements of variation would then only present the changes in then reference period.

Interim financial information

Where an entity publishes interim financial statements on an exceptional basis, and it is not possible to prepare comparative interim financial statements for the corresponding previous period, the entity's annual financial statements for the previous period could be presented for comparative purposes as a simplification. This possibility should be generalised to all cases and not only where it is not feasible to prepare interim financial statements for the previous period (see comments on section 37).

Information on transition to IFRS for SMEs

See comments on question 10.

Question 10 - Transition guidance

Section 38 *Transition to the IFRS for SMEs* provides transition guidance for SMEs that move (a) from national GAAP to the IFRS for SMEs and (b) from full IFRSs to the IFRS for SMEs.

Do you believe that the guidance is adequate? If not, how can it be improved?

Paragraph 38.1 makes no distinction between application guidance for transition from full IFRS or from some other set of accounting standards, i.e. national accounting standards.

The CNC believes that the two situations should be dealt with separately, since IFRS for SMEs are, by definition, closer to full IFRSs than to another set of standards.

This remark leads to the following proposition:

- transition rules for entities that migrate from full IFRS to IFRS for SMEs, (entities that are no longer listed for instance) ;
- transition rules for entities that migrate from local GAAP to IFRS for SMEs.

In general, the CNC considers that the section is not user friendly and that further explanations like those in IFRS 1 are necessary.

Moreover, the exceptions in IFRS 1 have not been adapted to the SME environment. The CNC proposes a simplification for tangible assets, consisting of a reallocation of net book values in the opening balance sheet based on the new definitions, and with a prospective application of the new rules, in order to limit retrospective adjustments. Furthermore, the CNC emphasises that it is more difficult for an SME to restate information in the notes than in the balance sheet and income statement. With this in mind, the CNC recommends eliminating comparative information in the notes (to avoid reconstituting information for the previous period for first time adopters).

Lastly, the CNC notes the lack of transition guidance for entities migrating from IFRS for SMEs to full IFRS. This situation should be dealt with in the standard to enable SMEs to determine the consequences of an upgrade.

Question 11 - Maintenance of the IFRS for SMEs

The Board expects to publish an omnibus exposure draft of proposed amendments to the IFRS for SMEs approximately every other year. In developing such exposure drafts, the Board expects to consider new and amended IFRSs that have been adopted in the previous two years as well as specific issues that have been brought to its attention regarding possible amendments to the IFRS for SMEs. On occasion, the Board may identify a matter for which amendment of the IFRS for SMEs may need to be considered earlier than in the normal two-year cycle.

Is this approach to maintaining the proposed IFRS for SMEs appropriate, or should it be modified? If so, how and why?

In order to ensure the maintenance of a self-contained set of standards for SMEs, the IASB needs to implement an appropriate update process. The CNC recommends that IASB or IFRIC staff should be dedicated to drawing up and interpreting sections of the standard, if the propositions of the exposure draft are to be implemented i.e. a separate process for exposure drafts and interpretations (see comments in point 4 of the covering letter).

Attachment 2: Detailed comments by section

Section 2: Concepts and Pervasive Principles

General remarks on the section

The CNC believes that, if it is intended to create a conceptual framework for IFRS for SMEs, it should not be included in amongst the other sections, and therefore "Concepts and pervasive principles" should be the leading section that "heads up" all the others (see comments in covering letter).

Moreover, the CNC notes that certain definitions of the same importance appear either in section 2 "Concepts and pervasive principles" or in the glossary. This presentation should be avoided as it does not facilitate the understanding of the text. General concepts should be included in the framework section (assets, liabilities….) and other definition should be included in the relevant sections and gathered in the glossary. Definitions should never be directly included in the glossary without being initially/previously posted/reported in the appropriate sections (see comments in covering letter).

Particular remarks on the section

Substance over form (paragraph 2.6)

Although the IASB cannot take into account legal and fiscal constraints prevailing in individual jurisdictions in drawing up standards, the latter cannot be totally ignored. The CNC wishes to stress that the standard is not applicable in its present form to individual accounts in France. There are two major obstacles to the application of the substance over form principle set out in IFRS for SMEs to individual accounts in France, namely accounting for leasing and mergers.

Timeliness (paragraph 2.10)

The CNC considers that this paragraph is not helpful to users and that the section would be streamlined if it were removed.

Initial recognition of financial assets and liabilities

The CNC notes that, according to paragraph 2.40 in section 2, assets and liabilities are measured at historical cost on initial recognition, unless another measurement base, such as fair value, is required by this draft standard ("initial recognition at cost unless if").

The CNC considers that, for financial assets and liabilities, initial measurement at fair value would be more consistent with IAS 39. In this case, it would be stipulated that fair value is generally equivalent to transaction price, except in exceptional circumstances. Hence, when the transaction is not carried out at market rate, fair value is different to transaction price and a profit or loss on initial recognition may be recorded. An adjustment would only be required where the effect is significant by analogy with paragraph AG 79 of IAS 39.

Subsequent measurement of financial assets and liabilities

Paragraph 2.41 of section 2 relating to subsequent measurement stipulates that financial assets and liabilities are measured at fair value, unless another basis, such as amortised cost, is required by the draft standard ("subsequent measurement at fair value unless if").

The CNC considers that this principle from the framework is inappropriate, and that this paragraph should be revised. In order to be consistent with IAS 39, the subsequent measurement of financial liabilities should be at amortised cost, subject to exceptions stipulated in the draft standard.

The terms of the paragraph are more appropriate for financial assets, even if some categories of financial assets are measured at amortised cost and others at fair value.

In conclusion, the CNC recommends that the exposure draft should set out clearly the following principles for subsequent measurement of financial assets and liabilities:

- assets are measured at fair value except for loans, receivables, and marketable securities for which fair value can not be determine reliably which remain at amortised cost ;
- liabilities are measured at amortised cost, except for liabilities with separable embedded derivatives ;
- derivative instruments are measured at fair value.

Measurement of the elements of financial statements (paragraphs 2.30 and 2.31)

In view of the work in progress on "fair value measurement", the CNC considers that reference to "fair value" should be limited to easily determinable assets and liabilities such as quoted securities.

The reference to present value made in several sections, should also be included in these paragraphs. In the same way, the reference to realisable value which only appears in section 12 « stocks », could also be included.

General recognition and measurement principles (paragraph 2.32)

This paragraph refers to section 10 "Accounting Policies, Estimates *and Errors"*. The CNC thinks it would be more coherent to insert section 10 after section 2.

Initial and subsequent measurement (paragraphs 2.40 à 2.44)

The references to initial and subsequent measurement principles (historical cost, fair value) should be removed from this section and the measurement principles should be directly included in the relevant sections.

Offsetting (paragraph 2.45)

The principle should be removed from this section and included in the section dealing with presentation of financial statements.

Sections 3 to 8: Presentation of financial statements

General comments relating to the sections

In general the CNC agrees with the sections on presentation of financial statements and the options proposed except for the presentation of the statement of income and retained earnings in place of the income statement and statement of changes in equity.

The CNC does not agree with the possibility of presenting a sort of comprehensive income statement (Statement of income and retained earnings) which presents an entity's profit or loss and changes in retained earnings for a reporting period if the only changes to its equity during the period arise from profit or loss, payment of dividends, corrections of prior period errors and changes in accounting policy. Indeed SMEs are very attached to the current presentation of the income statement which does not include changes in equity. In addition the CNC does not agree that the IASB anticipates some future changes proposed in IAS 1 (« SORIE ») which are not yet expressly approved by IASB (cf. 4 on cover letter).

The CNC suggests that these limited changes to equity could be presented at the bottom of the balance sheet rather than in the statement of income and retained earnings.

SMEs are also very attached to standardised models of financial statements. Standardised models facilitate the preparation of financial statements and enable comparison between entities.

In addition the implementation guidance needs to be more developed with more examples of illustrative financial statements. For example the implementation guidance does not include any example of a statement of changes in equity. The illustrative example of the statement of changes in equity presented in the guidance on implementing of IAS 1 could be included in the implementation guidance of IFRS for SMEs.

Detailed comments relating to the sections

Presentation of financial statements

The CNC does not agree with the possibility for entities to use titles for the financial statements other than those used in the draft standard (paragraph 3.19). It is in contradiction with the objective of comparability, it does not constitute a simplification and could be misleading. The CNC suggests the deletion of this paragraph.

In order to simplify the presentation of the balance sheet, the CNC suggests that the distinction between current and non-current assets or liabilities should be made by reference to a period of twelve months rather than by reference to the normal operating cycle and to trading activities:

- current assets and liabilities are expected to have a probable date of maturity less than twelve months ;
- non-current assets and liabilities are expected to have a probable date of maturity more than twelve months.

The CNC also proposes to classify some items (such as pension obligations and provisions) systematically in non-current liabilities and to disclose information about the probable maturity date of these liabilities, if these information are reliably determinable.

Statement of changes in equity and statement of income and retained earnings

As SMEs are generally owned by an individual not by a parent company, the requirements of paragraph 6.2 (c) should be suited to this case.

There is an inconsistency between paragraph 3.16 and paragraph 6.4. Paragraph 3.16 states that « *If the only changes to the equity of an entity* ***during the periods*** *for which financial statements are presented arise from [...]* ». This paragraph refers to the two periods presented in the financial statements. Paragraph 6.4 states that « *Paragraph 3.16 of this draft standard permits an entity to present a statement of income and retained earnings in place of the income statement and statement of changes in equity if the only changes to its equity* ***during the period*** *arise from [...]* ». This paragraph seems to refer only to one period presented. It should be clarified whether the limited changes to the equity which are considered for this presentation are changes which occur either in the two periods presented or only in the current period. In the latter case a line "restatement" should be introduced for the other changes which occurred in the comparative period and did not relate to payments of dividends, corrections of prior period errors and changes in accounting policy.

Cash flow statement

If the two methods (indirect and direct) are permitted, the CNC suggests deleting the reference to IAS 7 (paragraphs 18 – 20) in paragraph 7.9 and including the paragraph 19 of IAS 7 which deals with the direct method even if the direct method is less used by entities.

The definitions of cash and cash equivalents in the glossary should be reinstated in the section 7.

The CNC suggests completing the last sentence of paragraph 7.2 as follows: « *However,* ***<u>in some countries</u>****, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash and cash equivalents* ».

In order to clarify the classification of cash arising from acquisition or disposal of subsidiaries, the CNC suggests adding the requirements related to the acquisitions and disposals of subsidiaries and other business units of IAS 7 (paragraph 39 up to paragraph 42 or a summary of these paragraphs) directly in section 7. The illustrated example of cash flow statement in the implementation guidance of IFRS for SMEs should be amended to include this item.

The CNC wonders whether the cash flows arising from acquisitions and disposals of subsidiaries or other business units should be presented separately and classified as operating activities (paragraph 7.10) or as investing activities (paragraph 39 of IAS 7). There seems to be no explanation for that change compared to the requirement of IAS 7.

Factoring and discounting are very common transactions performed by SMEs. The CNC suggests that the section indicate the classification of these transactions (cash or financing activities) in connection with section 11. The CNC also suggests that an example should be included.

Notes to the financial statements

The CNC proposes to add in section 8 the requirements of paragraph 126 of IAS 1 which detail general information published with the financial statements if not disclosed elsewhere. This information is illustrated in the example provided in the implementation guidance of IFRS for SMEs « *Accounting policies and explanatory notes to the financial statements for the year ended 31 December 20X2* ».

The CNC also proposes to add in section 8 examples suited for SMEs to illustrate information about judgements (paragraph 8.6) and information about key sources of estimation uncertainty (paragraph 8.7).

Section 9: Consolidated and Separate Financial Statements

General remarks on the section

Consolidation of subsidiaries under temporary control (see comments on question 2)

According to the requirements of paragraph 9.1 of the exposure draft of IFRS for SMEs, the consolidated financial statements of a parent company include all its subsidiaries, including those acquired for sale. As a consequence, the acquired assets and liabilities of such subsidiaries will need to be measured at fair value on acquisition and then disclosed separately as “Non-current assets held for sale” if the sale is highly probable at that date (see paragraphs 36.5 and 36.6).

As a simplification, the CNC proposes excluding from consolidation, on acquisition, investments in an entity acquired with a view to sale, as long as this sale is seriously planned in the short term i.e. within 12 months. This proposed simplification does not reduce the relevance or the usefulness of the financial statements since it will enable, at the very last, disclosure of the short term recoverable amount of the investment in the books of the acquirer. Moreover it is consistent with the previous requirements of IAS 27 (before the publication of IFRS 3) which excluded from consolidation the “*subsidiary acquired and held in the unique perspective of disposal in the near future*”.

In such situations the CNC proposes that the investment in the acquire shall be recognised as a financial asset of the parent company and measured at the lower of its carrying amount and fair value less costs to sell (as set out in section 36).

Acquisition and disposal of minority interests (see comments on question 2)

The accounting treatment of changes in a parent’s interest in a subsidiary that do not result in a loss of control is described in section 21 “Equity”. According to this section, the changes in interest are treated as transactions with equity holders in their capacity as equity holders of the subsidiary. However, this treatment reflects recent decisions of the Board in IFRS 3 phase II,

in favour of the "*economic entity approach*" instead of the "*parent entity extension method*" for the preparation of consolidated financial statements. The CNC's comment letter on the exposure draft indicated that this approach seemed unsuitable and required further reflection before being finally adopted. The CNC also drew attention to the fact that the Board had not so far demonstrated that the application of these principles produced more relevant information than that which gives priority to the viewpoint of the shareholders of the parent company. Indeed, the CNC reiterates its opposition to this proposal and the resulting consequences. The CNC recommends the second approach, which is more consistent with the view that the manager/owner is, as much as other users including the shareholders, one of the primary users of the financial statements. Under this approach and with a view to simplification, changes in minority interests would be recognised as transactions with third parties and would affect the income statement (in the case of disposals) or goodwill (in the case of acquisitions, i.e. additional acquisitions would not affect the value of identified assets and liabilities determined at the date of control but would impact directly goodwill.).

Lastly, from this point of view, these requirements should be reclassified under the section dealing with the preparation of consolidated financial statements instead of the section on "Equity".

Certain requirements need clarification or further guidance

Definition of control

With respect to the definition of control, the CNC notes that the rules dealing with potential voting rights described in paragraph 9.9, are incomplete and should be defined more precisely.

In this case, if the IASB's intention is to be consistent with the requirements of IAS 27, the CNC considers it essential that the guidance in IAS 27 concerning these rights should be reproduced in the standard for SMEs and requests that the IASB clarify this point by inserting the requirements of IAS 27 in section 9.

Preference shares of minority interests

The issue of preference shares of minority interests arises frequently in the SME environment. For this reason we also request that paragraph 36 of IAS 27 is inserted in this section.

Combined financial statements

As with the guidance on accounting for reverse acquisitions in IFRS 3 it appears most desirable, considering the special characteristics and the frequency of this type of financial statements, that guidance should be given on the practical implications of their preparation. To this end, the guidance would set out:

- the rules defining the combination perimeter/scope and the definition of combination relationships (family relationships, existence of agreements, common management …) ;
- the rules for determining equity and minority interests ;
- the measurement principles for combined assets and liabilities on initial recognition where the combination arises from a pooling of interests rather than an acquisition ;
- the independent nature of the accounting principles applied in the presentation of combined financial statements.

This guidance would satisfy the double objective of ensuring the comparability of the financial statements and limiting the risks of divergent interpretations for common situations as well as facilitating the implementation of IFRS in a context where the solutions are not necessarily intuitive.

Section 10: Accounting Policies, Estimates and Errors

General comments relating to the section

The CNC agrees with the hierarchy proposed in paragraph 10.3 and paragraph 10.4 of section 10, except that pre-eminence should not be given to full IFRS when the IFRS for SMEs does not specifically address a transaction, other event or condition.

The CNC believes that it is too burdensome to require SMEs to change their accounting policy in accordance with the transitional provisions of full IFRS, if an amendment is made, if the SME has followed the requirements of a full IFRS. In fact paragraph 10.9 (b) requires that "*when the IFRS for SMEs requires or permits an entity to follow the requirement of a full IFRS and the requirements of that IFRS change, the entity shall account for that change in accounting policy in accordance with the transitional provisions, if any, specified in that IFRS"*. The requirement in paragraph 10.9 (b) is a consequence of the use of cross-references to the full IFRSs in the IFRS for SMEs. Application of paragraph 10.9 (b) means that any amendment to an IFRS in full IFRS that is applied via a cross-reference has to be applied by SMEs. The CNC believes this will be very burdensome for the SMEs as it means that SMEs have to be up-dated on all amendments to both the full IFRSs and the IFRSs for SMEs just because they choose to apply an option that is available by a cross-reference to full IFRS. This underlines the importance of making the IFRSs for SMEs a standalone document, without cross-references to full IFRS, in order to be able to manage the necessary changes in due course.

Detailed comments relating to the section

The definitions in the glossary should be reinstated in the section (for example: retrospective application, prospective application, impracticable).

Guidance on implementing this section should be added: examples of accounting estimates (extracted for example from IAS 8.32), the three examples of the guidance on implementing of IAS 8.

In order to clarify the application of the retrospective method, the expression "as far back as is practicable" in paragraph 10 should be replaced by "as it is practicable for the entity".

The CNC suggests that paragraph 10.10 should be amended to clarify that this paragraph requires that the comparative information for prior periods presented in the financial statements shall be adjusted when applying the retrospective method.

Paragraph 10.11 should be clarified because it seems to be in contradiction with section 38 relating to the transition to the IFRS for SMEs which deals with the initial application of the IFRS for SMEs. This paragraph should only apply in case of amendments to the IFRS for SMEs not in case of initial application.

Section 11: Financial Assets and Financial Liabilities

General comments on the section

The CNC finds this section too complex for SMEs and thinks that more simplifications are necessary. The CNC is not in favour of references to IAS 39 and thinks that the section should be stand alone.

This section would be easier to understand if the treatment of financial assets and financial liabilities were dealt with separately. In this context, and still with a view to simplification, the concept of the derivative instrument should be introduced including guidance on initial and subsequent recognition. Whilst the concept of the derivative instrument should be included, the CNC considers, on the other hand, that it is not necessary to include the concept

of embedded derivatives, and is therefore in agreement with the approach in the exposure draft.

The CNC considers in general that the scope of financial instruments measured at fair value is too broad, and should apply to fewer financial liabilities for which amortised cost should be the reference measurement base.

With respect to hedge accounting, the CNC believes that simplifications are necessary, and that purchases of options should be treated as hedging instruments. The use of option in order to hedge forecast highly probable transactions against currency risk are common in SMEs.

Lastly, the CNC agrees with the restrictive requirements in respect of the de-recognition of financial assets, as well as allowing the reversal of impairment through profit and loss, including for equity instruments, even if this treatment is in contradiction with IAS 39.

Derivative instruments

The CNC believes, from a general standpoint, that the exposure draft should distinguish more clearly requirements for non derivative financial assets and financial liabilities and set out for each of these two categories the definitions, the principles relating to initial and subsequent recognition and de-recognition.

Moreover, after having made this distinction, the CNC recommends introducing the concept of the derivative instrument which is currently only dealt with via paragraph 11.2 (h).

Derivative instruments should, in the CNC's opinion, be measured at fair value on initial recognition. On subsequent measurement, derivative instruments would also be measured at fair value, except for derivatives linked to unlisted instruments. Unrealised losses generated by derivatives linked to unlisted instruments would, however, be provided for on subsequent measurement.

Scope

The CNC thinks the scope definition should be simplified.

Comments on commodity contracts

The CNC believes that the paragraphs relating to purchase and sale contracts of non-financial elements especially commodities should be more fully developed, as the requirements set out in paragraphs 11.4 et 11.5 are too brief.

Considering the specific nature of the subject, the CNC suggests including these requirements in a specific chapter for commodities as specialised industry. This chapter would deal with purchase and sale contracts for commodities and provide guidance for distinguishing wholesale and trading activities. The CNC also recommends including the text of paragraphs 5, 6 and 7 of IAS 39, as well as illustrative examples.

Comments on leasing contracts

The CNC suggests removing leasing contracts from the section on financial assets and liabilities and dealing with them in section 19 Leases so that all the requirements relating to this kind of contract are brought together in the same section. Consequently it will be necessary to ensure this section is complete .The accounting treatment of leasing contracts includes accounting principles for receivables and debts, indexation clauses, and contingent rentals, in particular those indexed to turnover.

Comments on insurance contracts

Insurance contracts subscribed to by an SME should be dealt with in the SMEs' accounting standard even though this subject is not yet covered by full IFRS. Consequently, the relevant requirements should be included in a specific chapter setting out recognition and measurement principles for premiums payable and claims received, irrespective of the issues

specific to the insurance business. This would enable a clarification of the difference between an insurance contract and an investment.

De-recognition of a financial asset

Overall position of the CNC

The CNC agrees with the proposed approach. The CNC notes that the wording of paragraph 11.24 (b) is very different to that of paragraph 20 (a) of IAS 39, with the consequence for financial assets to continue in most cases to be recognised by the transferor according to the exposure draft IFRS for SMEs.

The CNC considers that if all significant risks and rewards relating to the financial asset must pass to the transferee in order for de-recognition to take place, as set out in the exposure draft, then very few assets will effectively be de-recognised by the transferor.

Last, the CNC points out that de-recognition of financial assets are frequent transactions for SMEs.

Further details requested on the nature of the risks

The CNC thinks further details should be given of the kind of risks targeted in paragraph 11.24 of the draft IFRS for SMEs, which can be transferred on disposal of financial assets, such as: interest rate, currency, credit risk, risk of late payment, and particularly the risk of dilution (the risk that the financial asset would not be recoverable due to claims on the commercial transaction. This risk is independent of the credit risk of the debtor).

To the extent that in transactions under which receivables are transferred by entities to financial institutions,

- the risks which are not generally taken over by the financial institution and which continue to be borne by the transferor are the risks of dilution and late payment;
- the risk which may be taken over by the financial institution is the credit risk,

the CNC suggests that further explanations should be given on the expression "all of the significant risk".

Comment on transfers of guarantee instruments (see comments on question 1)

With respect to the requirements of paragraph 11.26 which deals with accounting for guarantee instruments for both transferor and transferee, the CNC considers it unlikely that SMEs would be transferees under this type of transaction and suggests limiting the requirements of this paragraph to the case of the transferor.

Subsequent measurement of financial assets

The CNC agrees with the proposals in the exposure draft for accounting for financial assets. The CNC is firmly attached to the principle of measuring certain types of financial assets at cost or amortised cost (those mentioned in the exposure draft, mainly loans and receivables, as well as unlisted instruments, the fair value of which cannot be reliably determined). Moreover, the CNC agrees that the measurement categories should be limited to two (amortised cost and fair value through profit and loss).

Subsequent measurement of financial liabilities

General principles

The CNC considers in general that the scope of application of fair value to financial liabilities is too broad and recommends that subsequent measurement should be at amortised cost. The principle of measuring at amortised cost is applicable in particular to variable interest debts with non separable embedded options like caps, floors and tunnels, without leverage effect. The CNC considers that only financial liabilities including a separable embedded derivative

as defined in IAS 39 – although the concept of the separable derivative instrument should not be introduced in the exposure draft – as well as derivative instruments should be measured at fair value.

Comments on perpetual debts (see comments on question 1)

Paragraph 11.11 (e) stipulates that perpetual debts should be measured at fair value because they do not have a maturity date. The question arises, other than with respect to the accounting principle itself, as to whether SMEs actually issue this type of instrument and whether it is therefore necessary to provide this example.

Depreciation of financial assets

General principle

The CNC is in favour of allowing the reversal of provisions through profit and loss, including for equity instruments, even if this treatment is in contradiction with IAS 39.

Other comments

The CNC would like to remove the reference in paragraph 11.7(b) relating to commitments to make a loan and the reference to paragraph 11.7 (b) in paragraph 11.22 on impairment, because SMEs cannot generally grant loans (see comments on question 1).

The CNC is against using fair value to calculate the impairment of assets initially measured at cost as indicated in paragraph 11.22, because, by definition, fair value cannot be determined reliably for these assets. The CNC suggests adopting the terms of IAS 39 which refer to the "present value of estimated cash flows".

Hedge accounting

Overall position of the CNC on required simplifications

The CNC considers that simplifications should be introduced for hedge accounting (interest rate, currency, and price risks), without changing the basic principles:

- CNC suggests that derivatives should be defined in order to specify their accounting treatment. (see paragraph 2 above) Moreover the CNC considers that the following exceptions should be introduced in order to facilitate hedge accounting: separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the change in intrinsic value of an option and excluding change in its time value and separating the interest element and the spot price of a forward contract.
- a "short cut method" should be introduced with a presumed efficiency of 100% for the limited list of hedging instruments dealt with by the exposure draft, although purchases of options should be added to this list as recommended by the CNC;
- introduction of the « basis adjustment » i.e. the measurement of the effects of hedging in the acquisition costs of non-financial assets, mainly fixed assets and stock ;
- possibility of using "simple" options as hedging instruments, without having to apply all the requirements of IAS 39 ;
- where the "short-cut method" is not applied, presentation of guidance for the tests of hedging effectiveness (calculation and measurement methods, limits, accounting consequences) ;
- requirements dealing with the cases of discontinuance of the hedging relationships.

General position of the CNC on the purchase of options

The CNC thinks that the purchase of "simple" options should qualify as a hedging instrument. Details could be given of the types of option qualifying for hedge accounting: purchases of pure options, without leverage effect and without embedded written options. For example, caps, floors and tunnels should be able to qualify as hedging instruments for the interest rates of debt and currency options for forecasted highly probable purchase or sale transaction.

Comments on eligibility for hedge accounting

The CNC considers it necessary, that no ineffectiveness should impact the profit and loss account as long as the initial hedging transaction is not modified in the limited number of cases (as described in the exposure draft) where the "short cut method" could apply. For the other cases the recognition principle of the ineffective portion of the hedge relationship in profit and loss should be clarified. Moreover, the CNC also considers it necessary that the standard stipulates when effectiveness has to be tested, the range of ineffectiveness that is permitted and the way to measure ineffectiveness.

The CNC thinks that the standard should indicate clearly in paragraph 11.32 the instruments eligible for hedge accounting and those which are not.

It should be noted that a sales commitment should be added to paragraph 11.32 d (ii).

Lastly, the CNC questions the justification for 11.32(e), and asks whether options cannot be considered as hedging instruments.

Comments on the discontinuance of hedge accounting

With respect to paragraphs 11.35 and 11.36 relating to hedging a fixed interest rate or the price risk of a commodity held, the CNC considers that the standard should stipulate:

- the accounting treatment applicable in the examples indicated in paragraph 11.35 (a), (b) and (c) ;
- the treatment of the case where the hedged instrument no longer exists.

These explanations would then cover the case set out in the first paragraph of 11.36 for which full details are not given.

With respect to paragraph 11.39 for other hedging transactions, the CNC considers that the standard should stipulate explicitly the accounting treatment relevant to the cases indicated in 11.39 (a), (b) and (d).

Appendix on fair value

The CNC considers that Appendix B of section 11 with respect to the determination of fair value which is a direct extract from IAS 39 should be re-written in order to suit to the SMEs' environment.

Other comments

The CNC suggests removing the following requirements which concern more specifically banks and are not adapted to the SME environment in paragraphs 11.41 and 11.42:

- 11.41 (d) loan commitments measured at cost less impairment (paragraph 11.7 (b)) ;
- 11.42 […] "For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates"

Section 12: Inventories

General remarks on the section

Section 12 is largely derived from IAS 2 but without reproducing the text in its entirety. IAS 2 is a standard of four pages written in a simple understandable manner. The CNC considers that reproducing the text of IAS 2 in full in section 12 would meet the objectives of producing a simple stand alone IFRS for SMEs, and would better meet the practical expectations of SMEs with respect to this item which is important for most of them.

Detailed remarks

In spite of the preceding remarks, the present version of paragraph 12.11, relating to the effects of interest or price hedging instruments on stock valuation makes a reference to paragraph 11.33 (b) of section 11 "financial assets and liabilities".

This reference is too limited and should be replaced by the full text of paragraph 11.33 so that reference is made both to the hedged element and the hedging element. Moreover, the accounting treatment of the hedging of inventories should be revised (see above).

Section 13: Investments in Associates and section 14: Investments in Joint Ventures

The CNC does not believe that introducing several options in the consolidated financial statements for measuring investments in associates (equity method, cost model and fair value through profit and loss) and joint ventures (same options as for associates with in addition proportional consolidation) contributes to the simplification of IFRS for SMEs. On the contrary, the existence of multiple options detracts from the comparability of the financial statements produced by these entities. Consequently, it would be far more preferable as a general principle to adopt just one accounting model. In this case and by reference to what is already proposed in IAS 28 and IAS 31, the equity method should be adopted for measuring investments in associates and the latter method and proportional consolidation for joint ventures. However, given the difficulties in some cases of producing this information in time for reporting dates, cost and fair value models should be allowed by exception.

Section 15: Investment Property

Paragraph 15.4 of this section allows entities to opt for one of either the fair value model or the cost model, for all of their investment properties. In spite of this dual option, only the cost model is described in full in the standard. The section refers to paragraphs 33 to 55 and 75 to 78 of IAS 40 for the fair value model. To remain consistent with the requirement expressed in the introduction to this reply, since the fair value model is available to SMEs for measuring investment property, the CNC believes it should be set out in full in this section.

Section 16: Property, Plant and Equipment

Recognition

More details are required on the principles and practical methods of accounting for components of tangible assets. Indeed, the section gives no guidance on the initial recognition of components on acquisition or production, nor on the subsequent measurement of these components. This concept and application details should be included in the paragraphs dealing with the initial recognition of PPE and fuller details should be given in the part dealing with amortisation.

Measurement at recognition – plant, property and equipment produced by the entity

The definition of cost of PPE given in paragraph 16.7 is only applicable to acquisitions. It would be essential for this section also to give a definition of the costs to be included where the entity produces the asset.

Exchanges of assets

The CNC considers that the requirements of paragraph 16.10 dealing with exchanges of assets should be completed with a definition of the notion of "commercial substance" (see comments in section 17).

Acquisition through a public grant

See comments on section 17.

Spare parts and stand-by components

The CNC suggests completing the requirements of paragraph 16.2, by inserting in section 16 the following indications with respect to spare parts and stand-by components: « *Stand-by components are the principale spare parts of an installation held for use in case of breakdown or accidental breakage, in order to avoid stoppage of production or security risks. Their replacement is not planned. The economic benefits arising from this asset result from its immediate availability during the use of the main installation. Amortisation should commence on acquisition of the main installation and be carried out over the same period as for the main installation.*

Spare parts are intended to replace or be incorporated in a component of the main equipment. The economic benefits linked to this asset will only be obtained once the part is effectively used, after replacement. Amortisation should begin at the date of replacement of the part (i.e. when it is fitted) and is calculated in the same way as for the related component."

Day to day servicing expenditure

The CNC suggests that section 16 should stipulate under the heading recognition that day to day servicing costs should be dealt with as expenditure through profit and loss.

Amortisation

The current wording of paragraph 16.17 stipulates that "An entity shall review the residual value and the useful life of the asset at least at each annual reporting date". The CNC recommends that the annual review should only be compulsory by exception, in response to the variation of external and internal indicators.

Property, plant and equipment held for sale

See comments on section 36.

Disclosures

In paragraph 16.29 (e), point "(vi) net exchange differences" could be included with "(*vii) other changes"*.

Section 17: Intangible Assets other than Goodwill

General recognition principles

The CNC recommends inserting the requirements of paragraph 18 of IAS 38 as an introduction to the accounting treatment of intangible assets (definition, recognition and measurement):

IAS 38.18

"The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:

a) the definition of an intangible asset […]; and

b) the recognition criteria […].

This requirement applies to costs incurred initially to acquire or internally generate an intangible asset and those incurred subsequently to add to, replace part of, or service it."

Research and development costs

The CNC agrees with allowing entities the option of choosing between the expense model and the capitalisation model for accounting for research and development costs.

Separate acquisition

In order to clarify the components of acquisition cost, the CNC suggests, in addition to paragraph 17.8 on separate acquisition, inserting the examples of attributable and non-attributable costs included in measuring an intangible asset as set out in paragraphs 28 and 29 of IAS 38. This point does in practice raise considerable difficulties.

IAS 38.28

"Examples of directly attributable costs are:

a) costs of employee benefits (as defined in IAS 19) arising directly from bringing the asset to its working condition ;

b) professional fees arising directly from bringing the asset to its working condition; and

c) costs of testing whether the asset is functioning properly."

IAS 38.29

" Examples of expenditures that are not part of the cost of an intangible asset are:

a) costs of introducing a new product or service (including costs of advertising and promotional activities) ;

b) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

c) administration and other general overhead costs."

Acquisition by way of a government grant

Unlike section 16 "Property, Plant and Equipment", section 17 refers to section 23 "Government Grants", and indicates that the accounting treatment for intangible assets acquired by way of a government grant is covered. The issues raised by grants should either be dealt with exclusively in section 23, or in a uniform manner in both sections 16 and 17.

Moreover, the accounting treatment of internally generated intangible assets acquired by way of a government grant should also be dealt with.

Exchanges of assets

The CNC considers that the requirements of paragraphs 17.11 to 17.13 relating to exchanges of assets should be completed by the definition of commercial substance as defined in paragraph 46 of IAS 38.

IAS 38.46

"An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

a) the configuration (i.e. risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations."

Internally generated intangible assets other than goodwill / capitalisation model

Paragraph 17.16 refers to paragraphs 51 to 67 of IAS 38. In accordance with our general comments on cross referencing (see covering letter) these paragraphs should be introduced into this section after adaptation to SMEs.

Useful life

The requirements of paragraphs 17.24 and 17.25 should be illustrated by examples (such as those in paragraph 90 of IAS 38) to make it easier to understand the principle of useful life applied to intangible assets

IAS 38.90

« Many factors are considered in determining the useful life of an intangible asset, including:

a) the expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team ;

b) typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way ;

c) technical, technological, commercial or other types of obsolescence ;

d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset ;

e) expected actions by competitors or potential competitors ;

f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level ;

g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

h) whether the useful life of the asset is dependent on the useful life of other assets of the entity. »

Amortisation

As a simplification, the CNC recommends that the useful life and the amortisation method for intangible assets should only be re-examined at the reporting date when changes in internal or external indicators suggest it is necessary.

Section 18: Business Combinations and Goodwill

The CNC wishes to stress that it disagrees with the following points.

Scope

Combinations of entities under common control (see comments on question 1)

Although the CNC agrees with the Board's proposal not to exclude combinations of entities under common control from the scope of section 18, it considers that it is urgent for the Board to deal with this type of transaction, as explained in its reply to the exposure draft of IFRS 3 phase I. Such transactions are common in the SME environment and the standard for SMEs should cover all the transactions commonly encountered by them.

The most common transactions entered into by SMEs which affect both individual and consolidated financial statements are:

- mergers of two entities as part of the re-organisation of groups owned by individuals or legal entities;
- spin-offs with take-over of the transferee by the transferor, (where the transferor and transferee have the same parent entity) ;
- acquisition of 100% of a target entity followed by its absorption in the medium term ;
- spin-off of an activity to a subsidiary.

The CNC considers that a lack of guidance would seriously detract from the objectives of relevance and comparability set out in paragraphs 3 and 9 of section 2. Considering the role of these accounting principles for the population for whom they are intended, such common transactions for SMEs should be dealt with on the publication of this standard. They should be dealt with from the perspective of both consolidated and individual financial statements.

Transactions to be excluded from the scope of the section

The CNC is opposed to extending the scope of section 18, to business combinations involving cooperative entities to the extent that this implies de facto, that an acquirer is systematically identified in each combination .The CNC wishes to underline the difficulty or impossibility of identifying the acquirer other than on an arbitrary basis in most combinations involving cooperative entities. The CNC refers to the comment letter previously sent to the IASB with respect of the exposure draft of proposed amendments to IFRS 3, (see extract below).

« […] Business combinations involving […] cooperative entities frequently consist in forming a new entity in which member interests of the combining entities are brought together with no entity obtaining control over the others. Rather, the exchange of member interest usually entails an equal reapportioning of the combining organisation's board representation. The objective of the combining entities is clearly to uniting of interests with no ability for the pre-existing entities to take over the combined entity. In those cases, and based on the criteria defined by the current version of IFRS 3, no acquirer is to be identified and the purchase method would lead to account for such transactions using a method that is clearly not appropriate.

We, then, urge the Board to consider an alternative accounting method for business combinations where the purchase method is not appropriate. However, we believe that the IASB should not focus only on the fresh start method but rather complete its work on an alternative method to ascertain whether the fresh start method is a better method to account for business combinations for which no acquirer can be identified. »

Reverse acquisitions

The IFRS for SMEs, unlike IFRS 3, does not describe the treatment of reverse acquisitions. This lack of guidance may force SMEs to refer to IFRS 3, or to some other set of accounting standards, in order to determine the accounting treatment for the transactions they enter into. As these transactions are frequent for SMEs, the IFRS for SMEs should include, without reference to IFRS 3, full stand-alone guidance for individual and consolidated financial statements

The treatment prescribed by IFRS 3 is inapplicable, when the capital increase cannot be recognised by the target entity in its annual accounts but only by the absorbing entity or the apparent beneficiary, due to the legal environment in certain jurisdictions.

Paragraph 18.18: Contingent liabilities

Whilst reasserting its disagreement with the principle of recognising contingent liabilities in business combinations, as set out in the following extract from the CNC's comment letter on the exposure draft of amendments to IFRS 3, the CNC wishes to draw the Board's attention to the practical difficulties of measuring such potential obligations. This difficulty, already encountered by large groups that apply IFRS, will be even greater in an SME environment and detract from the quality of the information produced .We therefore propose eliminating this requirement and limiting recognition to those liabilities which are identifiable and measurable according to the terms of paragraph 14 of IAS 37. This proposal forms part of the simplifications requested for SMEs (information unavailable, excessive cost compared to the relevance of the information, unreliability of internal estimations, etc.). Entities will continue to be required to mention in the notes all information and risks associated with contingent liabilities.

Extract from the CNC's comment letter on ED IFRS 3 phase I

« We do not agree. We do not believe that identification and recognition criteria for the same contingent liabilities can be different in the standard on Business Combinations and in other standards dealing with the same elements.

Even if we agree with the Board that, since the contingency is known at the date of acquisition, the acquirer has effectively paid, an amount that takes into account a possible outflow, we, nevertheless, believe that the Board's proposal is not appropriate and that the Framework and IAS 37 criteria should be applied consistently.

As a result, a contingent liability should not be recognised when accounting for a business combination if, as of the date of acquisition:

- *It does not satisfy the general recognition criteria of a liability in paragraph 83 of the Framework. Under such criteria, a liability should be recognised if (a) it is probable that any future economic benefit associated to the item will flow from the enterprise and (b) it has a cost or a value that can be measured with reliability; and*
- *It, therefore, does not meet the recognition criteria of IAS 37.14:*
  - *an enterprise has a present obligation (legal or constructive) as a result of a past event,*
  - *it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation ; and*
  - *a reliable estimate can be made of the amount of the obligation.*

In addition, it is often difficult and almost highly impossible to reliably determine the fair value of such contingencies. We are convinced that the probability of the different outcomes can only be quantified with a large part of subjectivity that would not concur to reflect market expectations.

Considering the fact that we disagree with the Board on the recognition rules of the contingent liabilities, we therefore oppose the Board's proposal to measure contingent liabilities after initial recognition, at fair value with change in fair value recognised in profit or loss. We believe that this accounting treatment would impair the objective of consolidated financial statements (as prescribed by the framework paragraph 12) to provide useful and relevant information about the financial position of an entity. »

Paragraph 18.20: Treatment of Goodwill – Subsequent measurement

In addition to the method of depreciation based on systematic tests carried out at the reporting date, the CNC recommends introducing an amortisation option which would represent a real simplification for SMEs. If this were introduced, depreciation testing would only take place at the reporting date if there was evidence of impairment.

Paragraph 18.22: Treatment of "negative goodwill"

The CNC wishes to draw the Board's attention to the fact that the recognition of "negative goodwill" is a relatively common occurrence in the SME environment, in particular in business combinations resulting from legal adjudication of entities in financial difficulty. The take-over of entities in financial difficulty that consists amongst other in the purchase of a trade mark, customer base, or any other intangible item, usually involves the acquirer's commitment to retain all or part of the target entity's personnel, which may generate future costs or losses. In this situation, in order to avoid accounting for "Day one profit " which would be offset by future losses, the CNC suggests that the Board introduces a restriction to the principle of recognition in profit and loss on acquisition of identified intangible assets which cannot be valued by reference to an active market. According to this restriction (similar to the one which was set out in paragraph 40 of IAS 22), an intangible asset shall not be recognised by allocation of the acquisition price if that recognition leads to the creation or the increase of negative goodwill.

Other comments

The following remarks are not points of disagreement but concern the requirement to give clarifications or further details in connection with business combinations considered to be common in an SME economic environment. In most cases this will involve reproducing the principal requirements of IFRS 3.

Paragraph 18.14: Recognition criteria for intangible assets

The CNC requests clarification from the IASB with respect to the post-acquisition accounting treatment applicable to intangible assets such as research and development projects, in progress at the date of acquisition and recognised in a business combination.

In this particular case, the Board is requested to indicate whether or not it confirms the requirements of paragraph 45 of IFRS 3 and paragraphs 42 and 43 of IAS 38 relating to the recognition of research and development project costs incurred after acquisition, irrespective of the relevant accounting option exercised by the entity [*By exception to the requirements of IAS 38, the draft IFRS for SMEs introduces the option for entities to recognise internal R&D expenditure, in profit and loss when incurred , or as an asset if certain conditions are met*]. These clarifications should be included directly in section 18 in order to make the standard self-contained and readily useable by preparers of financial statements.

Adjustment period for the allocation of the cost of a business combination to goodwill and other assets acquired and liabilities assumed

Section 18 makes no reference to the 12 month adjustment period included in IFRS 3 (paragraph 62) during which, where additional information is available, assets and liabilities existing at the acquisition date (i.e. which meet the definition of assets and liabilities at that

date) may be recognised as identifiable assets or liabilities, or the relevant valuations allocated at the acquisition date may be adjusted accordingly.

The CNC considers that these measures should not only be available to groups applying full IFRS. They should be taken into the section since they represent a real simplification for SMEs.

Acquisition by stages

Acquisitions by stages are just as regular and common transactions for SMEs as for large groups. Consequently, the CNC considers that this section should include the requirements set out in paragraphs 58 to 60 of IFRS 3, as well as the relevant "illustrative examples" in the standard.

Section 19: Leases

Scope

The CNC believes that paragraph 19.2 in its current version is difficult for SMEs to understand. The scope of the section should be clarified and understandable. The CNC thinks this paragraph should be developed and adapted to the environment of SMEs.

In the absence of development and adaptation to SMEs the CNC would prefer the contracts referred to in paragraph 19.2 to be excluded from the scope of section 19.

Classification of finance leases

Section 19 proposes a classification distinguishing finance from operating leases, according to their qualitative characteristics. Additionally, the CNC suggests, as a simplification, introducing a numerical threshold for finance leases.

Initial recognition

Lessees shall recognise their rights under a finance lease as assets at fair value at the inception of the lease (paragraph 19.8).

The CNC would like to propose a simplification. In most cases, the fair value of the contract is equal to the sum of the present value of total lease payments and of the cost of exercising the purchase option.

Consequently, the CNC proposes the following modification of the wording of paragraph 19.8: « […] *lessees shall recognise their rights and obligations under finance leases as assets and liabilities at fair value, which* ***is presumed to be equal to the sum of the present value of lease payments and the price of exercising the purchase option, of the leased asset at the inception of the lease.»*** If this proposal is accepted, paragraph 19.12 (d) will have to be changed accordingly to include the reference to the fair value of the contract.

Operating leases

The CNC proposes the following simplification of the wording of paragraph 19.13: "*A lessee shall recognise lease payments under operating leases (excluding the cost of services such as insurance or maintenance) as an expense, on a straight line basis irrespective of the manner lease payments are made* ***unless this basis is not representative of the time pattern of the user's benefit which normally corresponds to a straight-line basis"***

Contingent rentals

The section does not deal with the treatment of contingent rentals (i.e. wholly or partially calculated on a variable basis). The CNC believes that SMEs' operating leases may often be of this kind depending on their activity (for example leases in shopping centres). The IASB is requested to develop an accounting treatment specifically adapted to SMEs for the contracts of this section.

Sale and leaseback

Paragraph 19.24 stipulates that: "*A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset .The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback depends on the type of lease".*

The CNC suggests eliminating systematically the effects of the sale when it is followed by a finance lease.

Section 20: Provisions and Contingencies

Initial recognition

According to paragraph 20.4 a), an entity shall recognise a provision when the entity has a present obligation as a result of a past event .The CNC suggests completing this paragraph by indicating that the obligation must exist at the reporting date.

If this modification is introduced, then CNC suggests removing paragraph 20.5 which is not particularly clear as it stands.

Paragraph 20.6 should be illustrated by examples. If it is intended that this paragraph should address specific provisions, such as provisions for de-commissioning, a list of the relevant provisions should be provided.

Initial measurement

As a simplification, and in order to ensure greater comparability, the CNC recommends the following modification to paragraph 20.8 b):

« When the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation~~. However, even in such a case, the entity considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount~~. »

Executory contracts

The scope of the section does not define executory contracts. This information should be given to SMEs. The CNC suggests including the definition and scope exclusion of paragraph 3 of IAS 37 in the section.

IAS 37.3

" Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. This Standard does not apply to executory contracts unless they are onerous."

Contingent assets

Under its current wording, paragraph 20.13 is too concise. The CNC suggests reproducing the definition of paragraph 32 of IAS 37 and adding illustrative examples.

IAS 37.32

"*Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the entity. An example is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.*"

Examples in the Appendix to Section 20

- Example 3 : restructuring

In(a) of the second paragraph, it should be made clear that the obligation must exist at the reporting date.

The CNC would like the examples of paragraphs 80 and 81[1] of IAS 37 to be included in the Appendix.

- Example 8 : Staff retraining as a result of changes in the income tax system

This example is unclear and is likely to cause confusion. We suggest that it should either be clarified or removed.

- Example 9: A court case.

The obligating event which gives rise to the provision for legal costs should be made clear. The example should also deal with the treatment of related fees and costs.

Section 21: Equity

General comments on the section

The CNC considers that the section is not "stand-alone" and needs to have more detailed requirements.

The CNC is against the principle of recognising separately the equity and debt components of the same instrument, because this is considered too complex for SMEs. It therefore suggests that compound instruments should be classified by convention either as equity or debt: convertible debt as debts and debt redeemable in equity with a pre-determined number of

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[1] *IAS 37.80*

« A restructuring provision shall include only the direct expenditures arising from the restructuring, which are those that are both :

a) necessarily entailed by the restructuring; and

b) not associated with the ongoing activities of the entity. »

IAS 37.81

« A restructuring provision does not include such costs as:

a) retraining or relocating continuing staff ;

b) marketing; or

c) investment in new systems and distribution networks.

These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognised on the same basis as if they arose independently of a restructuring. »

shares, as equity. Only the instruments giving rise to the creation or the delivery of a fixed number of shares would be classified as equity. Deferred share issues, such as share subscription notes, could also be classified as equity. The only debt component in these instruments would be one resulting from interests paid at market interest rates.

Moreover, it would appear more appropriate for the requirements relating to the acquisition of minority interests to be amended and transferred to the section on consolidation.

Specific comments

The CNC does not find paragraph 21.6 helpful and suggests eliminating it.

It should further be noted that section 11 on financial assets and liabilities also refers briefly, at the end of paragraph 11.9, to the possibility of recognising separately the components of compound financial instruments. The CNC, considering its position set out above which is opposed to the separate recognition of the components of hybrid instruments, considers this paragraph inappropriate and suggests that it should be replaced by a reference to section 21.

Section 22: Revenue

General comments on the section

Section 22, relating to the recognition of revenue from goods and services, is based on IAS 18 but does not reproduce the requirements of the standard in full. IAS 18 is a standard written in a simple and understandable manner. The reproduction in full of the requirements of this standard in section 22 would satisfy the objective of simplicity for a self-contained IFRS for SMEs, as well providing practical solutions to the numerous questions these entities may have in this respect.

Specific comments

Measurement of revenue

The agency relationship concept to which paragraph 22.4 refers should be defined and illustrated by examples.

Deferred payment

The CNC thinks this paragraph should be more explicit and provide examples adapted to the SME environment.

Exchanges of goods or services

The CNC considers that the requirements of paragraph 22.6 relating to exchanges of goods or services should be completed by inserting the definition of commercial substance.

IAS 38.46

« An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

a) the configuration (i.e. risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations. »

Construction Contracts

The CNC proposes a more detailed development of the part relating to construction contracts. To this end, the relevant paragraphs of IAS 11 relating to contract revenue (IAS 11.11 etc) and to contract costs (IAS 11.16 etc) should be included.

Discounts allowed by the entity

Paragraph 22.3, relating to trade discounts and volume rebates allowed by the entity is unclear. The CNC would like this paragraph to make it clear whether the fair value of the consideration received or receivable is measured gross or net of discounts and rebates allowed by the entity. The CNC suggests that the terms of paragraph 10 of IAS 18 should be adopted.

IAS 18.10

" [...] It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity."

Section 23: Government Grants

Accounting policy election

As stated in our general remarks on cross-referencing, paragraph 23.3 b) should not refer to IAS 20 but should include the necessary guidance for applying this policy.

Moreover, the CNC suggests, as a simplification, eliminating the choice between the two policies proposed and only allowing the treatment in IAS 20, which should be reproduced in full in the section.

Definition of government grants

The CNC would like a precise definition of government grants.

The CNC suggests that assistance that takes the form of reductions in social charges or taxation should be excluded. Indeed, the recognition of these aids as grants would be particularly complex and difficult to track over a period of time.

For example, tracking a reduction in social charges granted as a condition of maintaining a level of employment over a pre-defined period of time may turn out to be complex, all the more so because such measures often change in the course of their life.

Section 24: Borrowing Costs

The CNC agrees with the proposed treatment (see reply to question 5).

Section 25: Share-based Payment

In general, the CNC considers that the references to IFRS 2, particularly in paragraphs 25.4 and 25.7, are inappropriate since IFRS 2 is mainly intended for listed entities.

Whilst the CNC agrees with the recognition of an expense on the date an option is granted for "equity-settled" share-based payments, it considers that the measurement guidance should be adapted to an unlisted SME environment. The CNC considers the intrinsic value as set out in IFRS 2 is unsuitable, as it penalises SMEs by obliging them to carry out valuations at each reporting date, whereas for listed groups, where the fair value can be easily determined, measurement only takes place at the grant date.

With respect to "cash settled" contracts, the CNC believes the expense should be recognised at the grant date, and be re-measured subsequently at fair value .The CNC therefore agrees with the recognition and measurement principles for "cash settled" contracts set out in the exposure draft.

In addition, the CNC thinks that more detailed guidance should be provided with respect to the treatment of repurchase commitments made by the entity or its shareholders in order to maintain the liquidity of schemes in an unlisted entity environment.

Section 26: Impairment of Non-financial Assets

General comments on the section

The CNC disagrees with the proposed simplification for SMEs comprising an impairment calculation based on fair value because it is not relevant for assets which are not held for sale and because of the difficulties of making evaluation of fair value for groups of assets.

The reference to fair value could be maintained in certain cases to be defined (investments or individual assets), with the possible definition of a fair value hierarchy.

At the same time, the CNC considers that the concept of value in use cannot be ignored, in particular for assets not held for sale or for groups of assets.

Alternative proposals

The CNC is making alternative proposals for the calculation of impairment based on value in use.

The first possibility would be to introduce an option, under which impairment could be calculated either on the basis of the fair value or the value in use of the asset or group of assets.

The second possibility would be to define the asset categories for which impairment would be determined respectively by reference to fair value or to value in use given that two approaches are possible:

- operating assets : value in use, financial investments and assets that could be easily disposed of : fair value, or
- groups of assets : value in use, individual assets : fair value.

If value in use is introduced, the calculation method should be simpler than as required by IAS 36:

- no adjustment to eliminate the consequence (costs and increase in revenue) for restructuring and productivity ;
- discounting of cash flows at market rates after tax, risk related to the assets being included only in cash flows ;
- cash flow based on budgets approved by management.

Requests for clarification

Impairment versus accelerated amortisation plan

The CNC is uncertain as to when impairment should be recognised as opposed to implementing an accelerated amortisation plan, and thinks the draft standard could be clearer on this point.

Allocation of impairment

The CNC thinks that guidance should be provided to determine the methodology applicable when an individual impaired asset is grouped together with others, especially with respect to the allocation of impairment.

The CNC notes that the exposure draft adopts a different approach from IAS 36.

IAS 36 stipulates that where a cash generating unit is composed of different assets, impairment is calculated for the CGU as a whole, and then re-allocated to the constituent assets. Where the sum of the re-allocated impairment is less than the amount calculated for the CGU as a whole, then the un-allocated difference is not recognised.

The exposure draft stipulates in paragraph 26.22 that the impairment based on fair value is allocated proportionally to each component and, contrary to IAS 36, un-allocated impairment is dealt with through profit and loss. The CNC questions the recognition of provisions which do not appear to meet the definition of a liability.

Goodwill impairment

The exposure draft stipulates that, in order to determine the impairment of goodwill, a notional full 100% share of goodwill shall be calculated and compared to the full 100% share of the fair value of the CGU. These requirements are consistent with IAS 36, although less clear. The CNC considers that clarifications are necessary including examples, in view of the complexity of the subject.

Terminology

The CNC notes that the term “value in use” in paragraph 26.6 c, should be removed to the extent that the exposure draft only refers to fair value.

Section 27: Employee Benefits

General comments on the section

The CNC agrees with the proposals to provide for post-employment benefits including pension liabilities using a single method (projected unit credit method).

The CNC considers that options should be made available in order to avoid penalising the results of SMEs due to actuarial gains and losses, and past service costs.

With respect to actuarial gains and losses, the CNC considers that SMEs should have the choice of recognising them either in profit and loss or equity but corridor should not be available. With respect to past service cost, in particular when there are changes to the scheme, the CNC considers that SMEs should be allowed, as an option, either to recognise immediately or spread their effects over time in profit or loss.

Specific remarks

Paragraph 27.11: Multi-employer plans and state plan

The CNC disagrees with the requirement to provide for constructive obligations arising from deficits under multi-employer and state plan, and therefore proposes that the following requirement should be removed: "including any constructive obligation that goes beyond the formal terms" in paragraph 27.11.

In fact, the CNC considers that it would be difficult for an SME that contributes to a scheme to determine whether the latter is likely to be in deficit in the future, and if this were to occur what the SME's obligations might be with respect to absorbing the deficit.

Determination of the defined benefit obligation

The CNC suggests that the structure and wording of the part dealing with defined benefit liability should be re-organised as follows in order to clarify the requirements of the standard:

- determination of the entity's obligation under the plan and measurement method relevant to the financing of that obligation :
- determination of plan assets (paragraph 27.15 b) out of which the obligation is to be settled directly
- or externalisation of this obligation (points in paragraphs 27.11 and 27.12)

The CNC considers that the exposure draft does not give a precise definition of what constitute plan assets (for example, paragraph 27.20 deals with plan surpluses, although no methodology has been given for determining plan assets).

Measurement of the defined benefit liability

Paragraph 27.18 refers to the projected unit credit method. The CNC suggests grouping together what are currently paragraphs 27.23 and 27.24 with 27.18 as all three paragraphs deal with this method.

The CNC considers that the requirements relating to this valuation method are insufficiently explicit. If the standard is to be a stand-alone document then it is important for examples illustrating the calculation method to be given, even if in fact the work is carried out by actuaries.

The CNC thinks that paragraph 27.19 "Plan introductions, changes, curtailments and settlements» is not necessary as the requirements of this paragraph are included in paragraph 27.22.

Cost of a defined benefit plan

The CNC thinks that the requirements in respect of the net change in the defined benefit liability (paragraph 27.22) should be more explicit, and broken down between the components of the valuation of assets on one hand and liabilities on the other hand.

The CNC is unsure about the requirements of paragraph 27.25.

Information in the notes

The CNC thinks that the information in the notes should be more explicit.

With respect to paragraphs 27.38 b and 27.39, the CNC does not see the point in providing information about accounting policies for costs, as actuarial gains and losses are always recognised in profit and loss.

The information required in the notes in paragraph 27.38 c about changes in liabilities in defined benefit plans should be consistent with the presentation of the information in paragraph 27.22.

Section 28: Income Taxes

Paragraph 28.17 of the section requires an entity to "apply the principles in paragraphs 28 .15 and 28.16 [i.e. recognise a liability or an asset for deferred tax] at the time an asset or liability is initially recognised, whether acquired in a business combination or otherwise [e.g. an individual acquisition]". The exceptions to the recognition of assets and liabilities for deferred tax set out in paragraphs 15 and the following paragraphs of IAS 12 have been omitted, in anticipation of the future amendments of this standard currently under discussion by the Board. As stated in the covering letter, the CNC stresses that such an anticipation is inappropriate as these changes in the standard are still under discussion.

Moreover, whilst the main requirements of this section are adapted to the preparation of consolidated financial statements, their application in the individual statutory financial statements remains complex because of the specific issues relating to the latter.

Section 29: Financial Reporting in Hyperinflationary Economies

General comments on the section

The CNC considers this section unsatisfactory, because it is limited to a summary of IAS 29. For those entities in need of guidance on hyper-inflation, a summary would be insufficient (see comments on question 1).

Alternative proposal

The CNC therefore suggests inserting IAS 29 in its entirety at the end of the exposure draft with the sections dealing with specialised industries.

Section 30: Foreign Currency Translation

General comments on the section

The CNC agrees with the requirements of this section.

As the section is relatively complex, a certain number of simplifications would facilitate its implementation without changing any of the basic principles.

Proposed simplifications

As a simplification, the functional currency could be presumed to be the presentation currency, and the section would then stipulate, by exception, those cases where the functional currency is different to the presentation currency.

The CNC suggests as a further simplification that for the conversion of transactions in foreign currency the following distinction should be made:

- conversion of transactions in foreign currency in the individual financial statements,
- conversion of the financial statements of a subsidiary situated in a currency zone outside that of the parent company.

Other comments

In the CNC's opinion, paragraphs 30.14, 30.15 and 30.16 relating to changes in the functional currency could be omitted.

With respect to paragraph 30.23, relating to goodwill arising on the acquisition of a foreign operation, the CNC thinks this subject should be dealt with in an application guide, in particular acquisitions of groups with subsidiaries in different currencies to that of the

acquired parent entity. Moreover, the CNC is not against requirements different to those of IAS 21 on this particular point (i.e. goodwill converted in the parent entity's currency).

Lastly, with respect to disclosure in the notes, the CNC considers that paragraph 30.29 can be eliminated (when an entity presents its financial statements in a currency other than its functional currency).

Section 31: Segment Reporting and section 37: Interim Financial Reporting

The CNC agrees with the options proposed in the two sections but does not agree with the mandatory fallback to full IFRS (IFRS 8 and IAS 34) if an entity chooses to disclose segment information or issues interim financial report.

The CNC believes that specific requirements should be developed within the sections to deal with segment reporting and interim financial reporting when an entity chooses to disclose segment information or issues interim financial report.

Segment reporting

If segment reporting information is provided, specific requirements suited to SMEs should be included in the related section to specify what kind of information needs to be provided.

Interim Financial Reporting

If SMEs issue interim financial report, the requirements of IAS 34 should be adjusted for SMEs and included in the related section.

In addition, where interim financial statements are prepared on a one-time basis, the preparation of interim financial statements should be facilitated by permitting entities to use their prior annual financial statements as their comparative prior period information. It should be the general rule, not limited to circumstances where it is impracticable to prepare financial statements for the comparative prior interim period (extension of the scope of paragraph 37.2 to all cases).

Section 32: Events after the end of the Reporting Period

The CNC agrees with the requirements of this section but adds the following detailed comments.

The definition of the "*date when the financial statements are authorised for issue*" should be clarified by including the examples of paragraph 5 and paragraph 6 of IAS 10 in the section or similar examples suited to SMEs.

The going concern basis is only described in paragraph 3.7. It would be useful to include paragraph 14 up to 16 of IAS 10 in this section to enable SMEs to understand what accounting treatment is required when financial statements are not prepared on a going concern basis.

Section 33: Related Party Disclosure

The CNC has some concerns about the disclosure of individual personnel compensation for SMEs. If the disclosure of key management personnel compensation results in providing the individual compensation of one or two key managers, this information should not be required because it can be sensitive information for SMEs. The CNC agrees with the disclosure of general global information not individual information.

Detailed comments relating to the section

As SMEs are generally owned by an individual not by a parent company, the requirements of this section should be suited to this case (for example, in paragraphs 33.4, 33.9 and 33.10 the requirements concern only a parent entity).

Definitions in the glossary should be reinstated in the section (related party, related party transaction, close member of the family). Please refer to our covering letter.

Section 34: Earnings per Share

The CNC agrees with the Board's proposal not to make the disclosure of this information mandatory. However, if an entity chooses to produce this information, it should find the relevant guidance in the IFRS for SMEs without having to refer to IAS 33. Consequently, in line with the general comments in the covering letter, the CNC recommends the Board to insert the main requirements of the latter standard in section 34.

Section 35: Specialised Industries

Biological assets

The CNC considers that the measurement of biological assets at fair value should only be an option because it will be difficult to determine in the majority of cases. Moreover, as stated in the comments on section 34, the CNC recommends that the Board includes all the necessary guidance for applying fair value in the IFRS for SMEs so that it is not necessary for SMEs to consult IAS 41.

Section 36: Discontinued Operations and Assets Held for Sale (see comments on question 1)

As a simplification, without effect on the underlying principle which requires assets held for sale to be measured at the lower of their carrying amount and fair value less costs to sell, the CNC suggests that these requirements be transferred to each of the individual sections dealing with the relevant asset/activity.

As a simplification, it is suggested that non-current assets could be reclassified separately but without changing the valuation base applicable prior to the decision to sell i.e. amortisation could continue until disposal.

Section 38: Transition to the IFRS for SMEs

See reply to question 10

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Appendix 1: references to IAS or IFRS

List of transactions dealt with by cross reference to IAS or IFRS for which the treatment should be set out in full in the IFRS for SMEs.

Reference in IFRS for SMEs	*IAS or IFRS*	*Transaction*
§ 7.9	IAS 7 (paragraphs 18 to 20)	Use of the direct method in the cash flow statement.
§ 11.1	IAS 39 and IFRS 7	Accounting policy for financial instruments.
§ 12.10	IAS 23	Including borrowing costs in inventories.
§ 13.5	IAS 28	Measurement of investments in associates using the equity method.
§ 14.10	IAS 31 (paragraphs 28 to 40) and IAS 28	Measurement of investments in jointly-controlled entities by the equity method.
§ 14.11	IAS 31 (paragraphs 30 to 37)	Measurement of investments in jointly-controlled entities by proportionate consolidation.
§ 15.5	IAS 40	Fair value model for measuring investment property.
§ 16.13	IAS 16 (paragraphs 31 to 42 and 77)	Revaluation model for a class of property, plant and equipment.
§ 17.16	IAS 38 (paragraphs 51 to 67)	Capitalisation model for research and development costs.
§ 17.23	IAS 38 (paragraphs 75 to 87)	Revaluation model for a class of intangible assets.
§ 19.15	IAS 17 (paragraphs 36 to 47)	Treatment of finance leases by the lessor.
§ 19.20	IAS 38	Depreciation policy for depreciable leased assets under an operating lease.
§ 23.3	IAS 20	Recognition/measurement of other government grants.
§ 24.4	IAS 23	Capitalisation model for borrowing costs.
§ 24.5	IAS 23	Disclosures with respect to capitalisation model for borrowing costs
§ 25.4	IFRS 2	Measurement of equity-settled share-based payment transactions.

Reference in IFRS for SMEs	*IAS or IFRS*	*Transaction*
§ 25.7	IFRS 2 (paragraphs 35 to 43)	Measurement of share-based payment transactions with cash alternatives.
§ 29.2	IAS 29	Entity whose functional currency is the functional currency of hyperinflationary economy.
§ 30.21	IAS 21 (paragraphs 42 and 43)	Translation of results into a different presentation currency by entity whose functional currency is that of a hyperinflationary economy.
§ 31.1	IFRS 8	Segment reporting.
§ 34.1	IAS 33	Earnings per share
§ 35.1	IAS 41 (paragraphs 10 to 29)	Measurement of biological assets at fair value.
§ 37.1	IAS 24	Interim financial reporting.