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Le Président

JH/NJ

N° 23

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ANC's comments on the EFRAG's Draft Advice on the compatibility of the IFRS for SMEs with the EU Accounting Directives

Dear Mrs Florès,

The ANC wishes to thank the EFRAG for the considerable amount of work put into the comparative study of the requirements of the Accounting Directives and the IFRS for SMEs and has the following comments:

On the overall context of the study

Whilst the ANC has no precise information on the exact scope of the European Commission's initial request, we note that the EFRAG carried out a comparison of the requirements of the IFRS for SMEs and the Directives and therefore limited its study to the technical accounting aspects. However, the Accounting Directives form part of European Law and have a broader scope. Fundamental differences between the Accounting Directives and the IFRS for SMEs are in fact excluded from the EFRAG's study:

- the Directives set out general principles whilst the IFRS for SMEs proposes precise accounting rules ;

- the Directives apply to all entities having a certain legal form whereas the IFRS for SMEs applies to entities without public accountability whatever their legal form. The concept of public accountability is not defined in the European legal framework ;

- the Directives were drawn up on the basis of legal considerations, such as for example, the protection of creditors, legal ownership, the distribution of realized profits, whereas the IFRS for SMEs does not take an entity's legal environment into account ;

- other European Directives, in particular EC Directives 78/855 concerning mergers of public limited liability companies and 2005/56 concerning cross-border mergers of limited liability companies, may be the source of further divergence from the IFRS for SMEs , because of differences in definitions and terminology.

The ANC considers that these aspects which are indissociable from the technical accounting issues should have been taken into account in the EFRAG's comparative study. The ANC will communicate these items to the European Commission in order to initiate a broader debate in Europe with a view to providing SMEs with accounting standards adapted to their needs.

On the approach adopted

In the study, the EFRAG defines "incompatibility" as accounting treatment required by the IFRS for SMEs which is not permitted by the EU Accounting Directives.
Therefore, if the IFRS for SMEs offers several options for the accounting treatment of a transaction or an event, an "incompatibility" only exists if none of these options is allowed by the Accounting Directives. The EFRAG ignores those cases where certain options available in the IFRS for SMEs may be contrary to the Accounting Directives. These cases do not represent "incompatibilities" in the EFRAG's view.

An entity could choose an option (or options) that does (do) not exist in the Accounting Directives, so that the resulting accounting treatment be incompatible *de facto* with the Directives. We suggest that these cases should be listed in order to clarify the choice of options available to entities.

Moreover, limitations and derogations in the Directives are not taken into account. If the IFRS for SMEs proposes a general accounting treatment corresponding to restricted circumstances or an option in the directive, no "incompatibility" is considered to exist. Such cases are, the measurement at fair value of assets and substance over form which are included by derogation in articles 42e and 4 of the Fourth Directive whereas these are general requirements in the IFRS for SMEs. Member States that have not exercised the option available under Article 42e will be in a position of "incompatibility" with the IFRS for SMEs; these cases could also be listed.

We further note that the EFRAG has not analyzed the requirements of IFRS for SMEs which are identical to those of the IASs in force on the 1st of May 2002, considering that contradictions existing between the Accounting Directives and the International Accounting Standards (IAS) in force on the 1st of May 2002 have been eliminated by the Directive 2003/51/CE of the 18th June 2003. However, as stated in the preamble of this directive, its main objective was to create uniform competitive conditions for European entities without necessarily implying full conformity between international standards and Directives. The amendments introduced by this Directive concern the presentation of financial statements, recognition of transactions according to their substance and the measurement of assets at fair value. However they just consist of options available to Member States.

Moreover, the EFRAG has decided not to deal with the situation where the option available under the IFRS for SMEs of applying the requirements of IAS 39 could give rise to "incompatibilities" with the Accounting Directives. As a result, we are uncertain whether an entity exercising that option could avoid these "incompatibilities".

Furthermore, to the extent the Directives do not stipulate precise accounting treatment, the EFRAG considers that there is no incompatibility with the IFRS for SMEs. The ANC stresses that this approach may raise fundamental interpretation issues. As an illustration, the notion of "Other Comprehensive Income" is undefined and does not exist as a concept in the Accounting Directives. Moreover, the discounting of liabilities is not explicitly envisaged (see comments on question 3). These concepts are, however, dealt with explicitly in the IFRS for SMEs.

On the results of the study

We do not share EFRAG's analysis in respect of the accounting for investments in associates and/or in jointly-controlled entities (see comments in point 3 below).

The EFRAG's study shows a very limited number of "incompatibilities" which in practice relate to unusual circumstances and have limited impact. This suggests that the IFRS for SMEs could easily be implemented in Europe.

However, this standard is based on the same principles as full IFRS which do not appear adapted to the accounts of small entities:

- The approach that sets out to make a point-in-time valuation of entities remains predominant, whereas this valuation should result from the recurrent performance of the entity measured through the profit and loss account;
- The investor is confirmed as the main user of the accounts whereas in SMEs the accounts are used first and foremost by the manager to run the business as well as being used by the commercial partners of the company;
- Priority is given to "substance over form", in opposition to the legal approach adopted in the Directives ;
- A certain degree of volatility is introduced into the accounts of small entities through fair value measurement.

The Accounting Directives and the IFRS for SMEs are not at the same level and they cannot be fully comparable because of differences in terminology and definitions. The EFRAG's approach in its comparative study could, after making some minor adjustments to the Directives, lead to the use of the IFRS for SMEs being permitted in Europe. However, this study is not an adequate basis for introducing a new set of accounting standards: the whole European legal framework needs to be taken into consideration.

In addition, the introduction of full IFRS in Europe in 2002 required an EU regulation : this new standard, the IFRS for SMEs, cannot therefore be introduced as a basis of a mere comparability study without changing the existing regulatory framework.

Lastly, it would be appropriate to determine if the accounting treatment proposed by the IFRS for SMEs corresponds to entities' needs and to current practice in Member States.

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The comments of the ANC set out in the attached appendix refer exclusively to the points identified in the EFRAG's draft advice letter as incompatible and possibly potentially incompatible with EU Accounting Directives. The ANC did not carry out further research in order to identify other possible incompatibilities.

The Chairman,

Jérôme HAAS

APPENDIX: COMMENTS OF THE ANC ON THE BASIS FOR CONCLUSIONS OF THE EFRAG ON THE COMPATIBILITY OF THE IFRS FOR SMES WITH EU ACCOUNTING DIRECTIVES

REQUIREMENTS OF THE IFRS FOR SMES CONSIDERED INCOMPATIBLE WITH THE EU ACCOUNTING DIRECTIVES

1 Extraordinary items

We agree with the EFRAG: Paragraph 5.10 of the IFRS for SMEs prohibits the presentation of items of income and expense as “extraordinary items”, which is not compatible with the requirements of Article 29 of the Fourth Directive.

2 Financial instruments at fair value

We agree with the EFRAG : certain financial instruments , in particular financial liabilities , must be measured at fair value according to the requirements of the IFRS pour SMEs but do not come within the scope of Article 42 a of the Fourth Directive. Paragraphs 12.7 and 12.8 of the IFRS for SMEs are therefore incompatible with the requirements of the Fourth Directive. The ANC stresses that this incompatibility should concern a very limited number of financial instruments (loans indexed at two rates, for example), that are rarely encountered in practice.

3 Measurement of investments in associates and jointly-controlled entities in the financial statements

We do not fully agree with the EFRAG for the following reasons:

The EFRAG considers that paragraphs 14.7 and 15.12 of the IFRS for SMEs require fair value measurement of investments in associates and jointly-controlled entities for which there is a published price quotation and that there is therefore an incompatibility with the requirements of the Directives.

If, for the purposes of its consolidated financial statements, an entity opts for the cost or the fair value model for measuring this type of investment, then there is, in our opinion, an incompatibility with the Accounting Directives which require a single method, namely the equity method.

The same applies to the measurement of investments in jointly-controlled entities if the entity uses the cost or a fair value model whereas the Seventh Directive permits the equity method or proportionate consolidation.

- The ANC notes that some might consider that there is an ambiguity as to whether the rule set out in paragraphs 14.7 and 15.12 of the IFRS for SMEs requiring fair value measurement for investments in associates and jointly-controlled entities for which there is a published price quotation is applicable to entities that have opted for the equity method stipulated in paragraphs 14.4 (b) and 15.9 (b).

  The ANC ‘s understanding is that paragraphs 14.4 and 15.9 set out general principles by proposing three measurement methods (including the equity method). Paragraphs 14.7 and 15.12 only apply where the cost method is used. We also note that the requirement to disclose in the notes to the financial statements information the published price of investments in associates and jointly-controlled entities for which the equity method is used (paragraphs 14.12 (c) and 15.19 (c) of the IFRS for SMEs, confirms that the equity method can be used for investments for listed companies.

As a result of our analysis, it therefore appears that the equity method may also be used for investments in associates and jointly-controlled entities for which there is a published price quotation.: there would be no incompatibility with the 7th directive.

The ANC stresses that the concept of "*non-separate financial statements*" does not exist in the European Accounting Directives. Having said this, if we consider the Seventh Accounting Directive is applicable to "*non-separate financial statements*" (i.e. financial statements of an entity that only holds investments in associates and/or jointly-controlled entities and that are not separate financial statements) the equity method also applies to "*non-separate financial statements*". If we consider the measurement of investments in associates and jointly-controlled entities in the « *non-separate financial statements* » within the scope of the Fourth Accounting Directive of the European Union, then Article 59 of this Directive would also allow the use of the equity method. The Accounting Directives of the European Union would not therefore be incompatible with the option available in the IFRS for SMEs to use the equity method.

4 Amortisation of goodwill over a 10 year period when an entity is unable to make a reliable estimation of its useful life

We agree with the EFRAG: the IFRS for SMEs requires a 10 year amortisation period to be used when it is not possible to make a reliable estimation of useful life, whereas the Fourth Directive requires goodwill to be amortised over 5 years unless a longer amortisation period can be justified. Therefore an incompatibility exists between Article 37.2 of the Fourth Directive and paragraph 19.23 of the IFRS for SMEs.

5 Immediate recognition in profit or loss of negative goodwill

We agree with the EFRAG: the IFRS for SMEs requires immediate recognition of negative goodwill in profit or loss whereas the Accounting Directives only allow immediate recognition of negative goodwill in profit or loss in certain cases. Consequently, paragraph 19.24 of the IFRS for SMEs is incompatible with the Accounting Directives.

6 Reversal of impairment loss recognized for goodwill

We agree with the EFRAG: the IFRS for SMEs specifically prohibits the reversal of impairment loss recognized for fixed assets whereas the Fourth Directive requires the reversal of impairment losses if the reasons justifying the impairment are no longer applicable. Consequently, paragraph 27.28 of the IFRS for SMEs is incompatible with the Directives.

QUESTIONS TO CONSTITUENTS

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

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

For the reasons set out in point 3 above, we are not convinced by the conclusions of the EFRAG in respect of the measurement of investments in associates or jointly-controlled entities in the consolidated financial statements.

Moreover, the compatibility of the requirements for the measurement of investments in associates and jointly-controlled entities in the “non-separate financial statements” as defined by the IFRS for SMEs with the Directives depends on whether the said requirements are within the scope of the Fourth or the Seventh Directive (see comments in 3 above).

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

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

Potential voting rights

The Directives do not indicate whether convertible instruments or options should be taken into consideration when determining the scope of consolidation. Article 1.1. d) of the 7th Directive requires contracts and agreements between entities also to be taken into account for determining the existence of control. Similarly it introduces as part of an option (§ 2.a), the notion of the power to exercise or actually exercise control. This is a question of interpretation of the notion of control which depends on judgment. Consequently we do not believe there is a clear-cut incompatibility in this respect.

“Less likely than not” liabilities

We believe this subject relates to the interpretation of the Directives and is outside the scope of the EFRAG’s study.
If the EFRAG’s study were to include interpretation subjects , then we believe that it should also deal with other subjects such as the notion of prudence, true and fair view, substance over form, materiality etc.

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

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

Our comments are restricted to those requirements of the IFRS for SMEs which the EFRAG identified in its draft advice letter as being incompatible with EU Accounting Directives. We did not carry out further research in order to identify other possible sources of incompatibility. However, we think the following items might be possible sources of incompatibility:

Other Comprehensive Income (OCI)
As a preliminary remark, we note that the concept of OCI is not defined in the Accounting Directives.

- *Statement of Comprehensive Income*

Article 22 of the Fourth Directive stipulates that “Member States may permit or require all companies or any classes of company, to present a statement of their performance instead of the presentation of profit and loss items in accordance with Articles 23 to 26, provided that the information given is at least equivalent to that otherwise required by those Articles".

In this statement, an entity must present only the information required by the Directives for the preparation of the profit and loss account. Therefore, since the IFRS for SMEs requires the recognition in OCI of items not mentioned in Articles 23 to 26 of the Fourth Directive, the result for the financial year could be different. Consequently, the requirements of the IFRS for SMEs in this respect are not, in our opinion, compatible with the European Directives.

Apart from Article 22, the Fourth Directive includes no requirements in respect of the Statement of Comprehensive Income. On the other hand, the Directive permits /requires the recognition of the following items in equity:

- changes in fair value of hedging instruments instruments (Article 42c(a)),
- exchange differences arising on monetary items that form part of a company(s net investment in a foreign entity (Article 42c(b)),
- revaluation differences on tangible fixed assets (Article 33.2).

The Accounting Directives do not permit the recognition of actuarial gains and losses on pension liabilities in equity whereas the IFRS for SMEs allows their recognition in OCI.

- *- Recycling items of OCI*

The directive is silent on the possibility of recycling items recognized in equity whereas the IFRS for SMEs requires it. As the Directives are silent on recycling, the EFRAG does not consider there is an incompatibility. However, as this subject has potentially significant impact on the profit and loss account, we feel that it is necessary to take a position on the accounting treatment proposed by the IFRS for SMEs.

Discounting liabilities

Article 32 of the Fourth Directive stipulates "The items shown in the annual accounts shall be valued in accordance with Articles 34 to 42, which are based on the principle of purchase price or production cost".
Article 42 of the Fourth Directive stipulates that "provisions may not exceed in amount the sums which are necessary". The combined effect of these two requirements is that discounting of liabilities is not explicitly authorized, whereas discounting of assets is specifically addressed by the Directives (Article 42 e).
Paragraph 21.7 of the IFRS for SMEs requires discounting.
As the Directives are silent on this subject, the EFRAG does not consider there is an incompatibility. However, we consider this point requires further analysis.

Different language versions of the EU Accounting Directives

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

We are not aware of any such situations.

Other issues

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

We have no further comments at this stage.