SAS Quadra 05. Bloco J. CFC
Brasília, Distrito Federal – Brazil
www.cpc.org.br

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Request for Information – Comprehensive Review of the IFRS for SMEs

Dear Board Members

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)[1] welcomes the opportunity to respond the questionnaire about the comprehensive review of the IFRS for SMEs.

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

If you have any questions about our comments, please contact Mr. Idésio da Silva Coelho Júnior (Idesio.S.Coelho@br.ey.com), vice-chair of international affairs and coordinator of a working group constituted to study any proposal issued by the IASB.

Yours sincerely,

Edison Arisa Pereira
Technical Coordinator
Comitê de Pronunciamentos Contábeis (CPC)

[1] The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

COMITÊ DE PRONUNCIAMENTOS CONTÁBEIS

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QUESTIONS and ANSWERS

PART A – Specific questions on Sections 1 – 35 of the IFRS for SMEs

S1: Use by publicly traded entities (Section 1)

Are the scope requirements of the *IFRS for SMEs* currently too restrictive for publicly traded entities?

Answer:

(b) Yes—revise the scope of the *IFRS for SMEs* to permit each jurisdiction to decide whether entities whose debt or equity instruments are traded in a public market should be permitted or required to use the *IFRS for SMEs*.

We acknowledge that the complete set of Standards (IFRSs) is the global benchmark for capital and financial markets. However, in some jurisdictions companies are too small that they could benefit from using IFRS for SMEs instead of IFRSs, even if they were publicly traded.

Each jurisdiction should evaluate the costs and benefits of applying a simplified model for public companies and then decide whether to allow or not the use or IFRS for SMEs. For example, a Stock Exchange could establish different levels of requirements for public companies, allowing smaller firms to use the IFRS for SMEs. Given that it's clear to potential investors that there are simplifications within the SME Standard when compared to IFRSs, we believe that it's a jurisdictional decision.

S2: Use by financial institutions (Section 1)

Are the scope requirements of the *IFRS for SMEs* currently too restrictive for financial institutions and similar entities?

Answer:

(b) Yes—revise the scope of the *IFRS for SMEs* to permit each jurisdiction to decide whether any financial institutions and other entities that hold assets for a broad group of outsiders as one of their primary businesses should be permitted or required to use the *IFRS for SMEs*.

Our answer is similar to question S1: we acknowledge that the complete set of Standards (IFRSs) is the global benchmark for financial institutions. However, in many jurisdictions there are financial institutions or similar entities that are too small and do not have complex transactions. These entities could benefit from IFRS for SMEs instead of the complete set of standards. Again, it should be a decision made by each jurisdiction, after comparing costs and benefits.

S3: Clarification of use by not-for-profit entities (Section 1)

Should the *IFRS for SMEs* be revised to clarify whether an NFP entity is eligible to use it?

Answer:

(a) Yes—clarify that soliciting and accepting contributions does not automatically make an NFP entity publicly accountable. A NFP entity can use the *IFRS for SMEs* if it otherwise qualifies under Section 1.

A NFP entity should not be automatically treated as "public accountable". They have donors that don't expect return, like investors. Jurisdictions may allow NFP entities to apply IFRS for SME or even to develop a model specifically designed for them.

S4: Consideration of recent changes to the consolidation guidance in full IFRSs (Section 9)

Should the changes outlined above be considered, but modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?

Answer:

(b) Yes—revise the *IFRS for SMEs* to reflect the main changes from IFRS 10 outlined above (modified as appropriate for SMEs).

IFRS 10 clarifies the definition of control. Thus, it better reflects the economic reality and this improvement should be brought into IFRS for SMEs.

S5: Use of recognition and measurement provisions in full IFRSs for financial instruments (Section 11)

How should the current option to use IAS 39 in the *IFRS for SMEs* be updated once IFRS 9 has become effective?

Answer:

(b) Allow entities the option of following the recognition and measurement provisions of IFRS 9 (with the disclosure requirements of Sections 11 and 12).

The definition of "SME" varies between jurisdictions. Thus, it's reasonable to assume that some entities would have more complex transactions than others. Allowing the option to follow IFRS 9 could help them to better reflect these transactions. Therefore, the actual version of the IFRS for SMEs should be revised to make reference to IFRS 9.

S6: Guidance on fair value measurement for financial and non-financial items (Section 11 and other sections)

Should the fair value guidance in Section 11 be expanded to reflect the principles in IFRS 13, modified as appropriate to reflect the needs of users of SME financial statements and the specific circumstances of SMEs (for example, it would take into account their often more limited access to markets, valuation expertise, and other cost-benefit considerations)?

Answer:

(c) Other—please explain.

The IFRS for SMEs should take into account the new guidance on fair value measurements under IFRS 13. Also, it would be easier for SMEs to look for guidance on fair value measurements in a separate Section. As a consequence, the guidance on fair value measurements on Section 11 should be eliminated and a new section should be developed.

S7: Positioning of fair value guidance in the Standard (Section 11) Should the guidance be moved into a separate section? The benefit would be to make clear that the guidance is applicable to all references to fair value in the *IFRS for SMEs*, not just to financial instruments.

Answer:

(b) Yes—move the guidance from Section 11 into a separate section
on fair value measurement.

Based on the reasons presented in the answer to question S6, the guidance on fair value measurements on Section 11 should be eliminated and a new Section should be developed.

S8: Consideration of recent changes to accounting for joint ventures in full IFRSs (Section 15)

Should the changes above to joint venture accounting in full IFRSs be reflected in the *IFRS for SMEs*, modified as appropriate to reflect the

needs of users of SME financial statements and cost-benefit considerations?

Answer:

(b) Yes—revise the *IFRS for SMEs* so that arrangements are classified as joint ventures or joint operations on the basis of the parties' rights and obligations under the arrangement (terminology and classification based on IFRS 11 *Joint Arrangements*, modified as appropriate for SMEs).

IFRS 11 seeks to better reflect the economic reality of joint arrangements. Now, the classification between "joint operations" and "joint ventures" is based on the essence of the arrangement, and not only on its formal structure. Thus, IFRS for SMEs should be revised and incorporate these changes.

S9: Revaluation of property, plant and equipment (Section 17)

Should an option to use the revaluation model for PPE be added to the *IFRS for SMEs*?

Answer:

(b) Yes—revise the *IFRS for SMEs* to permit an entity to choose, for each major class of PPE, whether to apply the cost-depreciation-impairment model or the revaluation model (the approach in IAS 16).

The IFRS for SMEs already allows the option for a SME to measure non-financial assets at fair value (for example, investment properties under Section 16, paragraph 16.1). If Section 17 is revised, allowing the option for the revaluation model for PPE, it would not necessarily make the Standard more complex, given that SMEs could still choose to apply the cost-depreciation-impairment model. Thus, the Standards should allow the application of the revaluation model.

S10: Capitalization of development costs (Section 18)

Should the *IFRS for SMEs* be changed to require capitalization of development costs meeting criteria for capitalization (on the basis of on the criteria in IAS 38)?

Answer:

(c) Other—please explain.

The mandatory treatment as an expense for development costs could impair the relevance of the financial statements of some SMEs, especially those that develop technology. On the other hand, the mandatory capitalization of development costs could also be a burden for many SMEs. As a solution, IFRS for SMEs could be revised in order to allow (and not to require) the capitalization if certain criteria are met. The SME should be required to disclose their accounting policies related to development costs in their notes.

S11: Amortisation period for goodwill and other intangible assets (Section 18)

Should paragraph 18.20 be modified to state: "If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be ten years unless a shorter period can be justified"?

Answer:

(c) Other—please explain.

On the impossibility to make a reliable estimate of the useful life of an intangible asset, it would not be reasonable to justify a shorter period for amortization. In addition, if it's not possible to estimate the useful life, maybe it's probable that the useful life is longer, and not shorter.

We acknowledge that it would be simpler for SMEs to treat goodwill as an asset with definite useful life, given that performing an annual impairment test could be costly. On the other hand, some SMEs would like to treat goodwill as an asset with indefinite useful life and, therefore, perform an annual impairment testing (similarly to IFRSs).

As a suggestion, the IFRS for SMEs could allow entities to choose between treating goodwill as an asset with definite useful life (as stated by the actual version of the Standard) or indefinite useful life (performing an annual impairment test). The SME should be required to disclose their accounting policies related to goodwill in their notes.

S12: Consideration of changes to accounting for business combinations in full IFRSs (Section 19)

Should Section 19 be amended to incorporate the above changes, modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?

Answer:

(b) Yes—revise the *IFRS for SMEs* to incorporate the main changes introduced by IFRS 3 (2008), as outlined above and modified as appropriate for SMEs.

S13: Presentation of share subscriptions receivable (Section 22) Should paragraph 22.7(a) be amended either to permit or require the presentation of the receivable as an asset?

Answer:

(d) Other—please explain.

The option to treat the subscription receivable as an offset to equity would be preferable. However, if the regulation in a given jurisdiction implies that the subscription receivable meets the definition of an asset, the IFRS for SMEs could allow this treatment. The revision of IFRS for SMEs should make explicit reference that an entity should recognize an asset only if meets the definition and the recognition criteria.

S14: Capitalization of borrowing costs on qualifying assets (Section 25)

Should Section 25 of the *IFRS for SMEs* be changed so that SMEs are required to capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, with all other borrowing costs recognized as an expense when incurred?

Answer:
(c) Other—please explain.

SMEs should be required to capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. This is in line with the recognition criteria of an asset. On the other hand, it could be costly for many SMEs (they would have to make judgments in order to classify an asset as a qualifying one). Therefore, a possible solution is to revise the IFRS for SMEs to allow the capitalization, instead of being mandatory. The SME should be required to disclose their accounting policies related to borrowing costs in their notes.

S15: Presentation of actuarial gains or losses (Section 28)

Should the option to recognize actuarial gains and losses in profit or loss be removed from paragraph 28.24?

Answer:

(b) Yes—revise the *IFRS for SMEs* so that an entity is required to recognize all actuarial gains and losses in other comprehensive income (ie removal of profit or loss option in paragraph 28.24).

IFRS for SMEs should be revised in order to be aligned to IAS 19. The new version of IAS 19 has a mandatory treatment for actuarial gains and losses. Maintaining the two approaches under IFRS for SMEs would lead the Standard to be broader than IAS 19, which is not the objective of a "simplified" model.

<u>S16</u>: Approach for accounting for deferred income taxes (Section 29)

Should SMEs recognize deferred income taxes and, if so, how should they be recognized ?

<u>Answer</u>:

(a) Yes—SMEs should recognize deferred income taxes using the temporary difference method (the approach currently used in both the *IFRS for SMEs* and full IFRSs).

The IFRS for SMEs should be revised, becoming aligned to the IAS 12. This topic is complex buy its nature and it's not necessarily related to the size of the entity.

<u>S17</u>: Consideration of IAS 12 exemptions from recognizing deferred taxes and other differences under IAS 12 (Section 29)

Should Section 29 be revised to conform it to IAS 12, modified as appropriate to reflect the needs of the users of SME financial statements?

<u>Answer</u>:

(b) Yes—revise Section 29 to conform it to the current IAS 12 (modified as appropriate for SMEs).

Given that the IASB eliminated the exemptions under IAS 12, the IFRS for SMEs should be revised to conform to this Standard. Otherwise, the IFRS for SMEs would be broader than the IAS 12, which is not the objective of a "simplified" model.

<u>S18</u>: Rebuttable presumption that investment property at fair value is recovered through sale (Section 29)

Should Section 29 be revised to incorporate a similar exemption from paragraph 29.20 for investment property at fair value?

<u>Answer</u>:

(b) Yes—revise Section 29 to incorporate the exemption for investment property at fair value (the approach in IAS 12).

IFRS for SMEs should be revised to incorporate this exemption. Otherwise, the IFRS for SMEs would be broader than the IAS 12, which is not the objective of a "simplified" model.

<u>S19</u>: Inclusion of additional topics in the *IFRS for SMEs*

Are there any topics that are not specifically addressed in the *IFRS for SMEs* that you think should be covered (ie where the general guidance in paragraphs 10.4–10.6 is not sufficient)?

<u>Answer</u>:

(b) Yes (please state the topic and reasoning for your response).

Three topics should be addressed in the IFRS for SMEs:
1) Fair value measurements: a specific Section dealing with fair value measurements, based on the IFRS 13. Please see answer to question S6.
2) Government grants: Section 24 scopes out government grants based on tax liability. The IASB should add to Section 24 guidance for the treatment for different types of government grants: income tax liability or value added liability.
3) Income taxes: in some jurisdictions, like Brazil, the government promotes a simplified mechanism to determine the income tax for SMEs. Instead of calculating the taxes based on the "taxable profit", the estimate is based over the entity's revenues. Therefore, the IASB should promote guidance for cases when the income tax is not based on taxable profit. A possibility is to make clear in Section 29 (paragraph 29.1) that income tax that is not based on taxable profit should be accounted as sales taxes (paragraph 23.4).

<u>S20</u>: Opportunity to add your own specific issues

<u>Answer</u>:

(b) Yes.

The first comment is related to an inconsistence about to the definition of Property, Plant, and Equipment (PPE). The definition of 'property, plant and equipment' in the Glossary is different from the definition presented in item 17.2. The term “investment” was added into the definition of PPE in the Glossary. Please, see both definitions below:

Definition of Property, plant and equipment as at item 17.2:
Tangible assets that:
(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and
(b) are expected to be used during more than one period.

Definition of Property, plant and equipment as at the Glossary:
Tangible assets that:
(a) are held for use in the production or supply of goods or services, for rental to others, ***for investment,*** or for administrative purposes, and
(b) are expected to be used during more than one period.

Please, consider the possibility to eliminate such ambiguity in the 2012 review of the IFRS for SMEs. It would be preferable to apply the definition stated in item 17.2 (without “for investment”), because it is consistent with definition in the IFRSs (IAS 16.6 and its Glossary) and avoids conflict to the 'investment property' classification.

The second comment is related to an inconsistence about to the definition of “Cash equivalents”. The definition of 'cash equivalents' in the Glossary is different from the definition presented in item 7.2. The term “risk factor” was added in the definition presented in the Glossary. While item 7.2 ignores the ‘risk factor’, but added the ‘purpose of management’. Please, see both definitions below:

Definition of Cash Equivalents as at item 7.2:
Short-term, highly liquid investments ***held to meet short-term cash commitments rather than for investment or other purposes***.

Definition of Cash Equivalent as at the Glossary:
Short-term, highly liquid investments ***that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value***.

Please, consider the possibility to eliminate such ambiguity in the 2012 review of the IFRS for SMEs. It would be preferable a definition that mixes both ‘risk’ and ‘purpose’ factors, for example:

Cash Equivalents are short-term, highly liquid investments ***that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value and held to meet short-term cash commitments rather than for investment or other purposes***.

The suggested definition is consistent with the concept of cash equivalent under IAS 7 that comprises both: the definition in IAS 7.6 and the purpose of meeting short-term cash commitments in IAS 7.7. Notice that, it is also aligned with the understanding presented by IFRIC in "IFRIC Update July 2009: Determination of Cash Equivalents".

The third comment is related to the need for clarification of the cost formula choice – Measurement of cost of goods sold: in many jurisdictions, prior to the adoption of the IFRS for SMEs, SMEs used to make accounting choices based on tax incentives (including Brazil). The cost formula choice is one example. In an inflationary environment (not necessarily hyperinflationary), managers prefer the weighted average cost formula (than FIFO) when either criteria is accepted by tax authority. However, the cost formula choice biased by tax incentives might mitigate the fair presentation of financial statements, if tax based choice does not represent economic substance of transactions.

Notice the Section 13 Training Material in this regard:

"An entity decides to measure the cost of inventories using the FIFO formula or the weighted average cost formula depending on its judgment of the method that leads to a fair presentation of its financial statements."

Therefore, the IASB should consider adding item 13.18 as follows:

13.18

An entity shall measure the cost of inventories, other than those dealt with in paragraph 13.17, by using the first-in, first-out (FIFO) or weighted average cost formula. <u>***Judgment of the cost formula might represent the way the entity manages its inventories.***</u> An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified. The last-in, first-out method (LIFO) is not permitted by this IFRS.

PART B:

<u>G1</u>: Consideration of minor improvements to full IFRSs

How should the IASB deal with such minor improvements, where the *IFRS for SMEs* is based on old wording from full IFRSs?

<u>Answer</u>:

(a) Where changes are intended to improve requirements in full IFRSs and there are similar wordings and requirements in the *IFRS for SMEs*, they should be incorporated in the (three-yearly) omnibus exposure draft of changes to the *IFRS for SMEs*.

<u>G2</u>: Further need for Q&As

Do you believe that the current, limited programme for developing Q&As should continue after this comprehensive review is completed?

<u>Answer</u>:

(a) Yes—the current Q&A programme should be continued.

<u>G3</u>: Treatment of existing Q&As

Should the Q&As be incorporated into the *IFRS for SMEs*?

<u>Answer</u>:

(b) No—the seven final Q&As should be retained as guidance separate from the *IFRS for SMEs*.

Some cases are too specific and if they are incorporated the Standard could become more complex.

<u>G4</u>: Training material

Do you have any comments on the IFRS Foundation's *IFRS for SMEs* training material available on the link above?

<u>Answer</u>:

(a) No.

The IASB should complete the training materials for all the Sections.

<u>G5</u>: Opportunity to add any further general issues

Are there any additional issues you would like to bring to the IASB's attention relating to the *IFRS for SMEs*?

<u>Answer</u>:

(a) No.

<u>G6</u>: Use of *IFRS for SMEs* in your jurisdiction

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This question contains four sub-questions. The purpose of the questions is to give us some information about the use of the *IFRS for SMEs* in the jurisdictions of those responding to this Request for Information.

Answers:

1 What is your country/jurisdiction?

Brazil.

2 Is the *IFRS for SMEs* currently used in your country/jurisdiction?

(d) Other (please explain).

In Brazil, the IFRSs are required for public companies, joint-stock companies, financial institutions and insurance companies. It's also required for private companies with annual revenues or assets above 300 million Reais or 240 million Reais, respectively. All other companies usually have to apply the IFRS for SMEs (with some exceptions, like subsidiaries of public companies). Thus, there are companies that usually would not be considered "small" or "medium-sized" applying IFRS for SMEs. The classification in Brazil is related to "public accountability" instead of size.

3 **If the *IFRS for SMEs* is used in your country/jurisdiction, in your judgment what have been the principal benefits of the *IFRS for SMEs*?**
(Please give details of any benefits.)

The initial benefit is to have a specific Standard for SMEs. Prior to the adoption of IFRS for SMEs, SMEs would look for guidance under the GAAP developed for larger companies (mostly designed for public companies).

4 **If the *IFRS for SMEs* is used in your country/jurisdiction, in your judgment what have been the principal practical problems in implementing the *IFRS for SMEs*?**
(Please give details of any problems.)

One potential problem is related to the application of IFRS for SMEs to micro-sized entities, because they would apply only a minor portion of the Standard.

There is a need for a specific guidance for the most frequent transactions made by micro-sized entities. In Brazil, the Conselho Federal de Contabilidade ("Federal Council of Accounting") is discussing an Interpretation designed for micro-sized entities. And we also acknowledge the efforts undertaken by the

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SME Implementation Group (SMEIG) about the development of a Guidance for micro-sized entities.