Final Report of the Survey on the ED-IFRS for SMEs among German SMEs

Contents

1 OBJECTIVES OF THE SURVEY

In response to IASB´s world-wide invitation to carry out surveys and field tests with regard to the ED-IFRS for SMEs, and in view of its legal tasks according to Article 342 HGB (German Commercial Code), the German Accounting Standards Committee (GASC) has initiated a survey with the aim of getting empirical evidence as to whether the ED-IFRS for SMEs, which was published in February 2007[1], might be able to meet the expectations and needs concerning financial reporting of SMEs in Germany. To guarantee the independence and the quality of the study the GASC commissioned the Chair of Financial Accounting and Auditing of the University of Regensburg (Prof. Dr. Axel Haller and Dr. Brigitte Eierle) to carry out the study. To get broader coverage and a higher public profile for the study, as well as additional expertise, the GASC cooperated with the Federation of German Industries (BDI) and the Association of German Chambers of Industry and Commerce (DIHK).

According to the IASB the IFRS for SMEs should meet the financial reporting needs of entities that do not have public accountability and publish general purpose financial statements for external users (ED-IFRS for SMEs 1.1). Publicly accountable entities are those which file, or are in the process of filing, their financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; or which hold assets in a fiduciary capacity for a broad group of outsiders (e.g. a bank, insurance entity, securities broker/dealer etc.) (ED-IFRS for SMEs 1.2). This definition of SMEs is a qualitative one and does not include any size criteria. However, the IASB leaves it to the national regulators to define more precisely the scope of the standard by also using size thresholds; e.g. such as in Article 267 HGB or Article 11 and 27 of the Fourth EU-Directive. The IASB´s broad qualitative definition of an SME defines the scope of the survey.

On the one hand the GASC wanted to use this survey to contribute to the initiative triggered by the IASB to investigate the specific needs of SMEs and their stakeholders with regard to financial reporting. The GASC therefore intends to deliver the results of the survey to the IASB and other interested institutions around the world that participate in the development process of the IFRS for SMEs. On the other hand the survey should also provide useful information to the German regulator, allowing him to base his decision to revise the national financial reporting rules in the German Commercial Code (HGB) on sound empirical data.

2 DESIGN OF THE SURVEY

2.1 Questionnaire

The survey is based on a questionnaire which was sent by mail to 4,000 SMEs, asking the director in charge of the annual accounts to fill it in. Return envelopes with postage paid were provided and confidentiality was guaranteed.

The content of the questionnaire aimed to get answers to the following areas of questions that are directly related to the ED-IFRS for SMEs:

a) What is the structure of the company? Can the assumption of the IASB be confirmed, that specific corporate structures and activities result in a higher need for internationally comparable accounting rules?

[1] For an overview of the ED-IFRS for SMEs see besides others *Haller/Beiersdorf/Eierle* (2007).

b) What issues are SMEs typically confronted with, and what issues occur relatively seldom and may therefore be regarded as not being generally relevant for SMEs? This should give an idea which issues need to be dealt with in the IFRS for SMEs and which might be left out.

c) How do SMEs evaluate the potential benefit and costs of the accounting rules of the ED-IFRS for SMEs? Concerning the benefit the evaluation should be twofold: one concerning the benefit for internal decision and management purposes, and one for the information need of external users of financial statements.

The questionnaire was conceived in such a way that it did not require any knowledge of IFRS or of the ED-IFRS for SMEs. Appropriate explanations were therefore provided with the questions – especially in the last part of the questionnaire, where the accounting rules of the ED-IFRS for SMEs had to be evaluated. In this way a fairly equal level of knowledge was aimed at, which should safeguard reliable and comparable answers. In addition, each question (where appropriate) had the answer category “impossible to evaluate” which also should contribute to the quality and reliability of the answers and therefore of the results.[2]

Due to this fact, the questionnaire had a length of 20 pages. It was developed within the cooperating institutions and in consultation with experts from outside during the period from October 2006 till March 2007. After a pre-test of the questionnaire the selected companies received a letter signed by the presidents of the four institutions with an invitation to participate in the survey. Four days later the questionnaires were sent out, in May. The companies were given four weeks to send the questionnaire back to the University of Regensburg. One week before the announced end of the period for sending the questionnaires back, a reminder letter was sent to the companies.

2.2 Sample selection

The entities included in the survey were drawn from the so-called MARKUS-Datenbank, a database containing approximately 886,000 German enterprises.[3] From this total all entities were excluded that do not meet the IASB´s definition of SMEs. In addition to this, entities with an annual sales volume of less than 8 m EUR, so to say the “small” entities according to Article 267 HGB and Article 11 of the Fourth EU-Directive were also excluded. This was because it is most likely that if the IFRS for SMEs have any relevance for SMEs in Germany, these entities might be excluded from the scope of application.[4] Out of the remaining 20,704 entities 4000 were selected by using a disproportionate stratified random sampling. The criteria for the clusters were the size and legal form of the entities.

This sample selection was chosen in order to get a sufficient number of questionnaires back from larger entities and those with specific legal forms, such as partnerships, limited partnerships and stock corporations and therefore to be able to get significant and relevant insights into the attitudes and evaluations of those entities. This would not have been the case in a purely randomly selected sample because small entities and particular legal forms, especially the limited liability company, are fairly over-represented, which would then also have been the case for the sample. This analytical advantage was seen by the researchers to outweigh the

[2] The frequency of this response is shown in the following figures of this report.

[3] This database contains entities of the German companies’ register which do have an acceptable credit rating of the Creditreform, an institution which evaluates the credit worthiness in Germany and other countries.

[4] Although the IASB does not limit the scope of the standard, the board members have agreed on having an entity of approximately 50 employees in mind, when developing the rules of the standard (see BC46).

disadvantage of the lack of proportional representation of the German landscape of SMEs. The four size-clusters were 8-32 m EUR, 33-50 m EUR, 51-100 m EUR and >100 m EUR of annual sales; the legal form clusters were AG (stock corporation), GmbH (limited liability company), GmbH&Co KG (limited partnership with a limited liability company as a general partner) , KG (limited partnership), OHG (partnership) and sole proprietorship. From each cluster a minimum of 250 entities were randomly selected. If the MARKUS database included fewer than 250 entities in particular cluster, all the companies of this cluster were selected (resulting in a comprehensive selection).

2.3 Questionnaire returns

The entities were asked to send the questionnaires back within four weeks. 428 completed questionnaires came back, of which 18 could not be included in the reasons shown in figure 1. Finally 410 questionnaires were usable for the analysis. This represents a response rate of 10.3%.

questionnaires sent out	4.000	
questionnaires returned	428	
rejected questionnaires, due to a		
listing on the stock exchange	6	
sales < 8 m EUR	11	
based abroad	1	
= analyzable questionnaires	410	(10.3%)

Figure 1: Questionnaire response rate

Due to the fact that not all questionnaires were comprehensively filled in, the following presentation of the results and answers given always provides the number of responses that were included in the analysis of a particular question (symbol “n”).

2.4 Comparison with other studies

Several surveys were carried out during the last years, which also focus on the attitudes and estimations of SMEs with regard to the internationalization of financial reporting. The GASC study is different and superior to those due to the following characteristics:

a) Large sample and high return rate;

b) Sample includes SMEs with all major legal forms and all sizes (over 8 m EUR annual sales) as well as from all over Germany (no regional or institutional restrictions);

c) Large volume of collected data due to the considerable number of questions;

d) Questions cover particular accounting rules and methods as well as other issues included in and/or related with the ED-IFRS for SMEs.

Due to these qualitative characteristics the study provides a valuable source of empirical data and a highly relevant insight into the financial reporting attitudes of German SMEs for the current discussion about the pros and cons of an IFRS for SMEs on an international and national level.

2.5 Characterization of the participating entities

The entities that answered the questions are broadly diversified in terms of size (annual sales as well as balance sheet total), legal form, and industry. More than half of the participating entities (55%) are companies with limited liability, 42% are partnerships. The low rate of only 3% of sole proprietorships shown in Figure 2 may be explained by the fact that this legal form is most likely only used by very small companies and was therefore under-represented in the selected sample of the study (see above chapter 2.2).

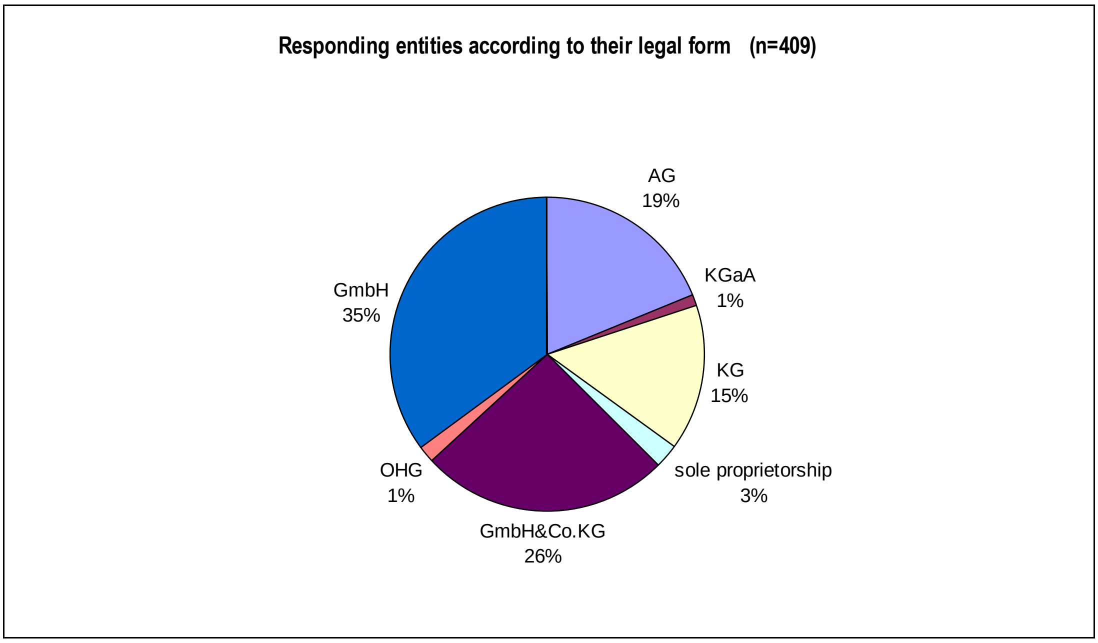

Figure 2: Legal form of responding entities

Figure 3 and Figure 4 show the representation of the size clusters in the sample according to annual sales and according to total assets.

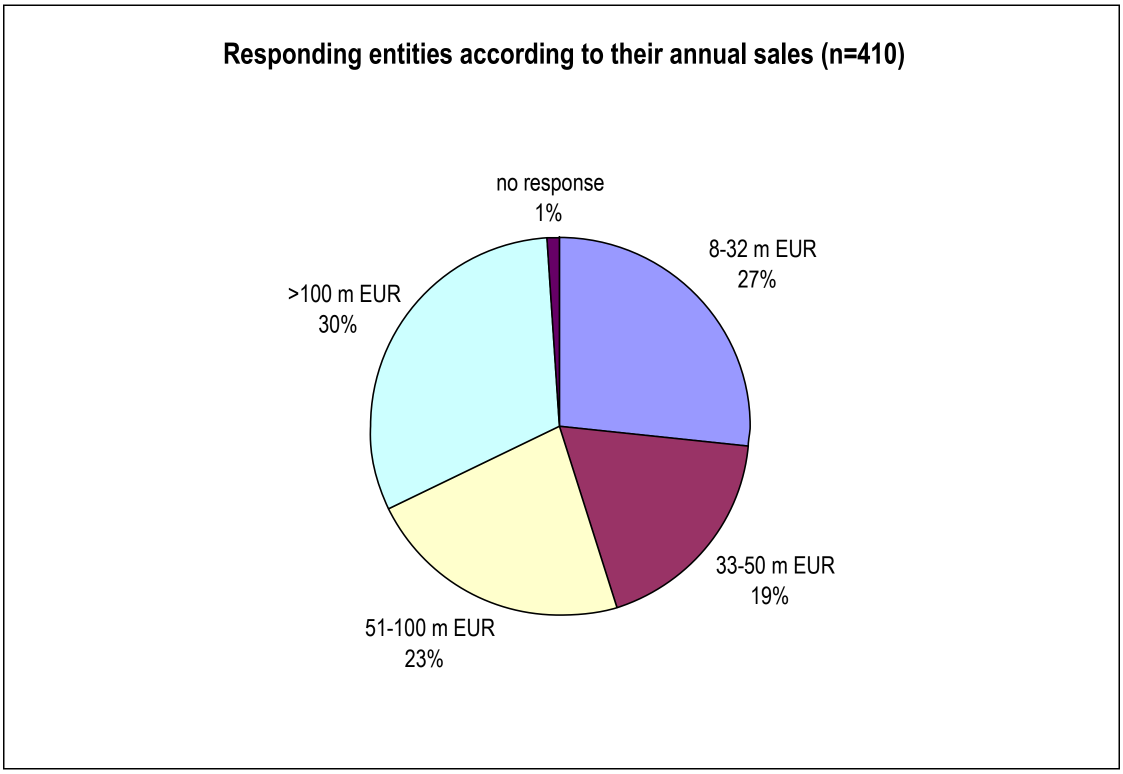

Figure 3: Responding entities according to their annual sales

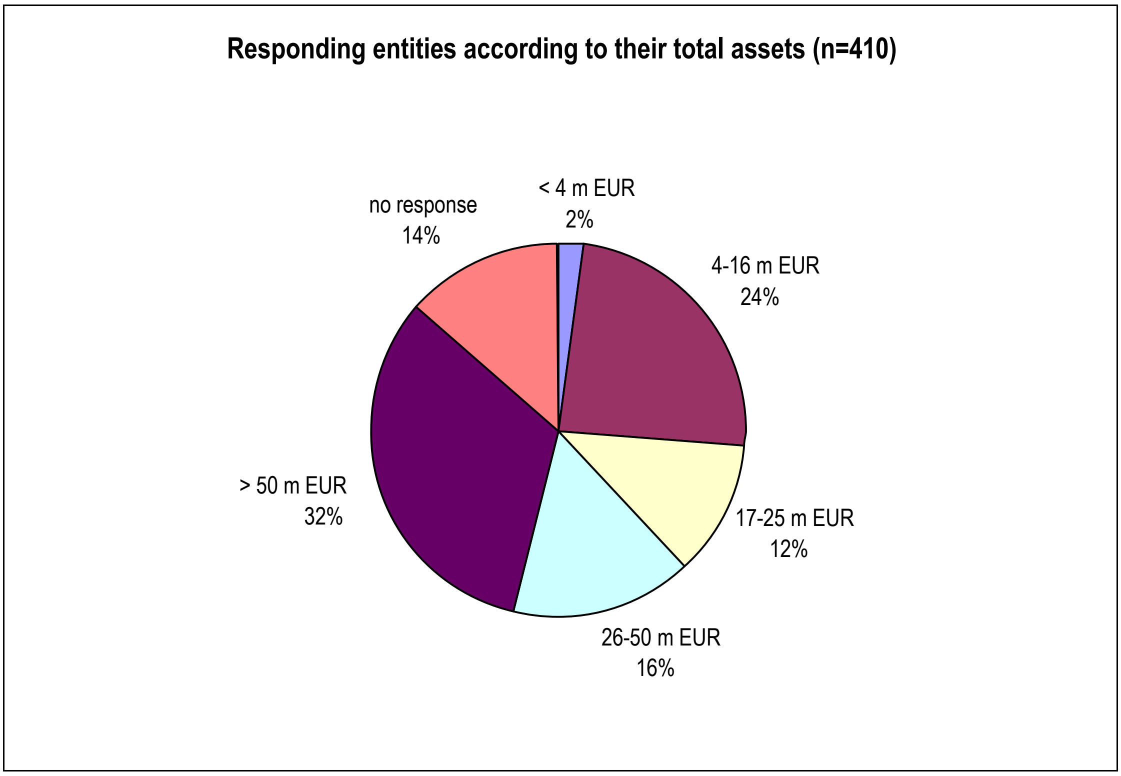

Figure 4: Responding entities according to their total assets

The participating entities represent the following industries:

Responding entities according to their industries on the basis of the federal statistical office's official classification of economic activities (n=410)	
Wholesale and retail trade	20%
Manufacture of machinery and equipment and transport equipment	16%
Real estate, business activities	10%
Manufacture of refined petroleum products, chemicals and plastic products	7%
Manufacture of basic metals	7%
Manufacture of food products, beverages and tobacco	6%
Manufacture of electrical and optical equipment	5%
Construction	4%
Electricity, gas and water supply	4%
Manufacture of pulp, paper and paper products; publishing and printing	4%
Transport, storage and communication	4%
Manufacture of textiles, leather and leather products, and textile products	2%
Manufacture of furniture and jewelry; recycling	2%
Manufacture of other non-metallic mineral products	1%
Others	2%
No response	5%

Figure 5: Responding entities according to industry

The IASB mentions SME owners who are not also managers of their SMEs as one of the main groups of external users (ED-IFRS for SMEs 1.1 (b), BC55 (e)). Therefore the participants were asked in the questionnaire about the number of owners of the entity and whether all owners are managers of the entity.

More than half of the participating entities have one (135 entities) or two (95 entities) owners. In total 85% of the entities have 1 to 6 owners. 52% of the entities with only one owner mention that the shareholder is not a person but a legal entity (company etc.). Although the largest number of mentioned shareholders in the survey is 6000, most of the shareholdings are quite small. Only 7.8% (32 entities) have more than 10 owners.

The statistical characteristics of the distribution of the owners of the participating entities are shown in Figure 6.

	minimum	maximum	mean value	standard deviation	median
number of owners in the last year	1	6.000	22	297.71	2

Figure 6: Distribution of numbers of owners

However, Figure 7 reveals that in 76% of the responding entities not all the owners are part of the SMEs management and therefore a considerable number of SMEs do – like publicly traded companies – have non-participating owners, which confirms the assumption of the IASB. However it also becomes obvious that this is in most cases a very small circle of owners.

Question: Are all owners also currently members of the board of directors? (n=399)

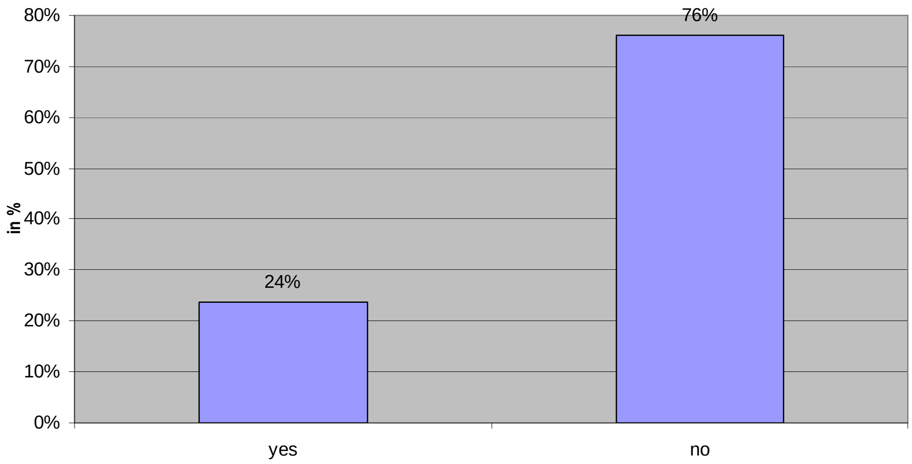

Figure 7: Existence of non-participating owners

Although the IFRS do not differentiate the objectives and rules of accounting for financial statements of the single entity and the group, this differentiation is made and is very important under German GAAP. In particular, the application of IFRS is required for consolidated financial statements of publicly traded companies and optional for those of all other companies. For separate financial statements IFRS may only be applied for publication purposes; however, they do not replace financial statements according to HGB, and these have nevertheless to be presented by all types of legal entities. [5] Due to this high degree of relevance as to whether an entity is part of a group or not for the probability of the application of IFRS in its accounts, the questionnaire contained questions focusing on this issue (see figure 8).

[5] Because of the particular legal environment (commercial and tax law) the German legislator has allowed separate financial statements presented under IFRS only for information purposes (see the basis for conclusions of the revision act, called "Bilanzrechtsreformgesetz" (BilReG-E, BT-Drucks. 15/3419, Basis for Conclusions, p. 23).

Question: Is your company the parent or a subsidiary of a group? (n=409)

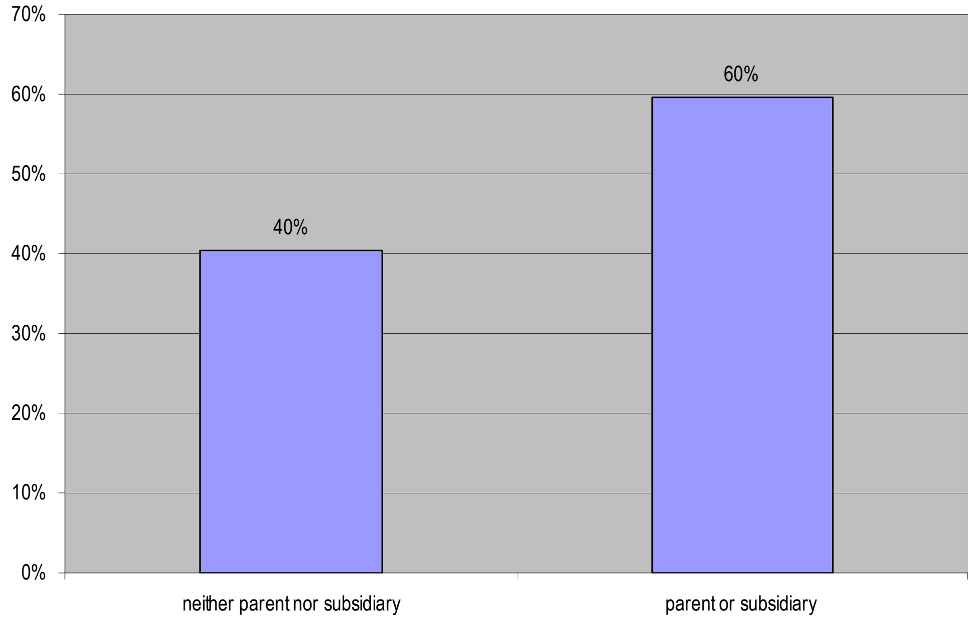

Figure 8: Part of a group

As figure 8 reveals, 60% of the participating entities are part of a group. However a considerable size effect becomes obvious, because in the sales cluster of 8-32 m EUR the proportion of group members is only 29%, in the cluster of 33-50 m EUR it is already 53% and it reaches 76% in the sales cluster of > 50 m EUR. The answers show also that subsidiaries of publicly traded parent companies must in most cases report IFRS data to their parent and therefore might evaluate the benefits of applying IFRS much higher than other entities. This might be derived from the finding of the survey that 62% of the 65 participating entities that mentioned that they already apply IFRS are subsidiaries. The answers to the questionnaire also reveal that internationally comparable accounting data are conceived as beneficial primarily by entities that are part of a group (see chapter 3.3).

A considerable number of the groups are cross-boarder structures; 36% of the responding entities stated that they have foreign subsidiaries.

3 GENERAL ASPECTS

3.1 Objectives of financial statements

As expressed in BC55 and Preface 7 and 1.1b) of ED-IFRS for SMEs the IASB regards banks, vendors, credit rating agencies and customers, in addition to the above mentioned non-participating owners, as the main groups of external users of financial statements of SMEs. The findings of the survey confirm this view only for banks and owners. The participating SMEs ranked the provision of information for those user groups as one of the most important functions of their separate as well as consolidated financial statements. Vendors and other stakeholders, such as employees, customers and potential investors are not regarded as important users of the financial statements of SMEs (which might be seen as a difference from publicly traded companies). The findings reveal that the SME´s management is also perceived as a main user of financial statements (separate as well as consolidated) (see figures 9 and 10); a fact that the IASB is conscious of, although it decided not to consider it in its standard-setting rational because the purpose of financial statements is to provide information to external users (BC31 ED-IFRS for SMEs). Unlike external users, the management can obtain any information needed to run the business and does therefore not rely on financial statement information.

Question: **How relevant to your entity are the following objectives of preparing separate financial statements?**

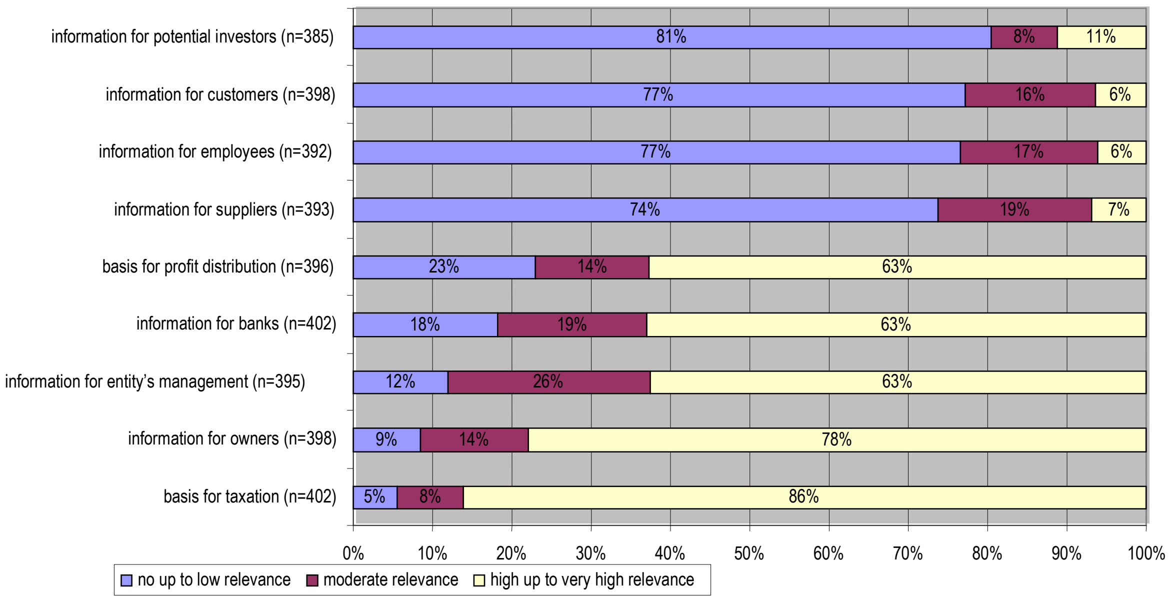

Figure 9: Objectives of separate financial statements

Question: How relevant to your entity are the following objectives of consolidated financial statements?

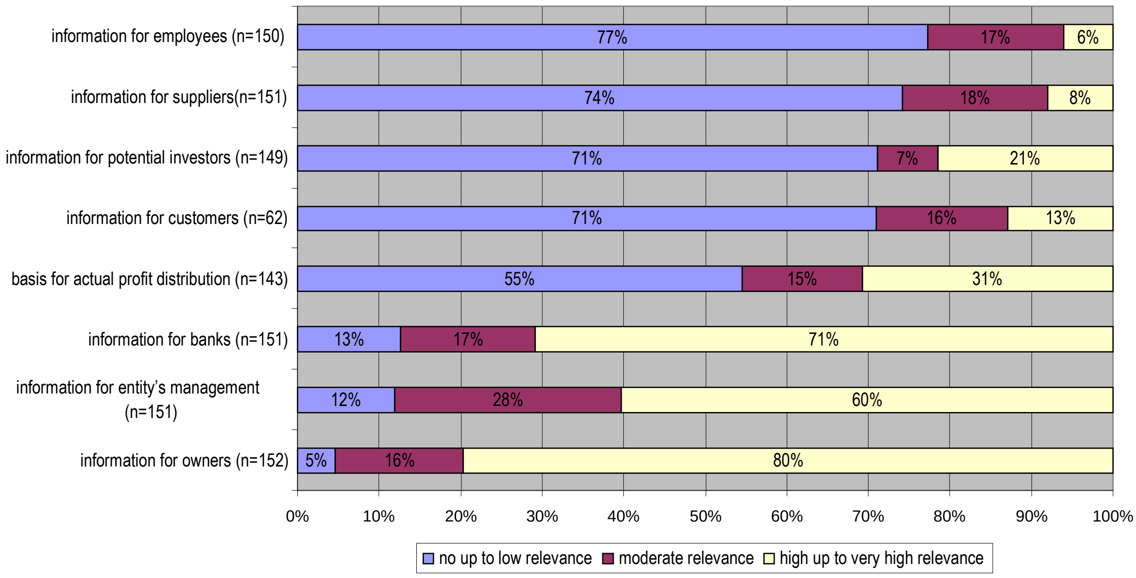

Figure 10: Objectives of consolidated financial statements

Although the IASB – for understandable reasons – excludes potential tax effects of the rules of the ED-IFRS for SMEs in its standard-setting rationale (see ED-IFRS for SMEs BC28-BC30), the study reveals that the separate financial statements of SMEs are still highly significant for the computation of income taxes in Germany. This connection between financial and tax accounting, which is referred to as the *Maßgeblichkeitsprinzip* (the principle of congruency) has a long tradition in Germany and has (with declining intensity) influenced financial reporting rules and practices in Germany for a long time. This fact is underlined by the statement of 79% of the participants that they try to present just one set of financial statements which complies with both financial accounting and tax rules (see figure 11). The formulation of this objective depends to some extent on the size of the entity (meaning in small companies the answer is more likely than in large ones), though it was also expressed by 75% of participants from the size cluster of > 50 m EUR of annual sales.

Question: **Do you try – as far as is legally possible – to present just one set of financial statements for both financial as well as tax purposes? (n=410)**

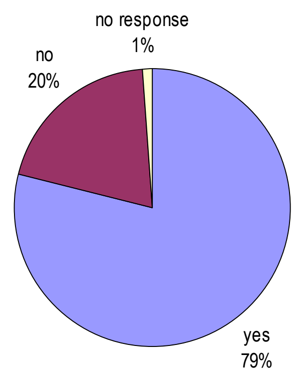

Figure 11: Aim to present one set of financial statements for financial as well as tax purposes

3.2 Cross-border activities

According to the IASB (see ED-IFRS for SMEs BC15) one of the main benefits of global financial reporting standards is the enhanced comparability of financial information or the improved efficiency of capital allocation and pricing; benefits that are – in IASB´s view – not limited to public accountable entities but can also be attained by SMEs, especially if they have cross-border activities and foreign stakeholders, such as lenders, customers, vendors and/or venture capitalists (ED-IFRS for SMEs BC16). In order to investigate whether German SMEs have such cross-border activities the questionnaire contained several questions about the level of internationalization. The responses reveal that there are considerable cross-border activities, but primarily with regard to sales and purchases of goods and services. 60% of the respondents say that exports have medium (15%) or (very) high (45%) importance for them. Half of the respondents assessed imports as of medium (22%) or (very) high (28%) importance (see figure 12).

The responses also show that cross-border finance is of only moderate relevance; 89% assess foreign equity and 90% foreign credits as having no or only very limited relevance. This correlates with the statement of 84% of the participants that they have very few or no financing in foreign currency. Also the comparability (benchmarking) with foreign competitors is only an issue for 29% of responding entities.

Analyzing the answers according to the size clusters a size effect becomes obvious: comparatively large entities have overall more cross-border activities than comparatively small entities (figures 13 and 14). However, even in the smallest size cluster (8-32 m EUR annual sales) exports are (very) important for 44% of the entities and at least 20% of the respondents have foreign competitors.

Question: **How relevant are the following foreign activities to your entity (or your group, if your entity is a parent company which prepares consolidated financial statements)?**

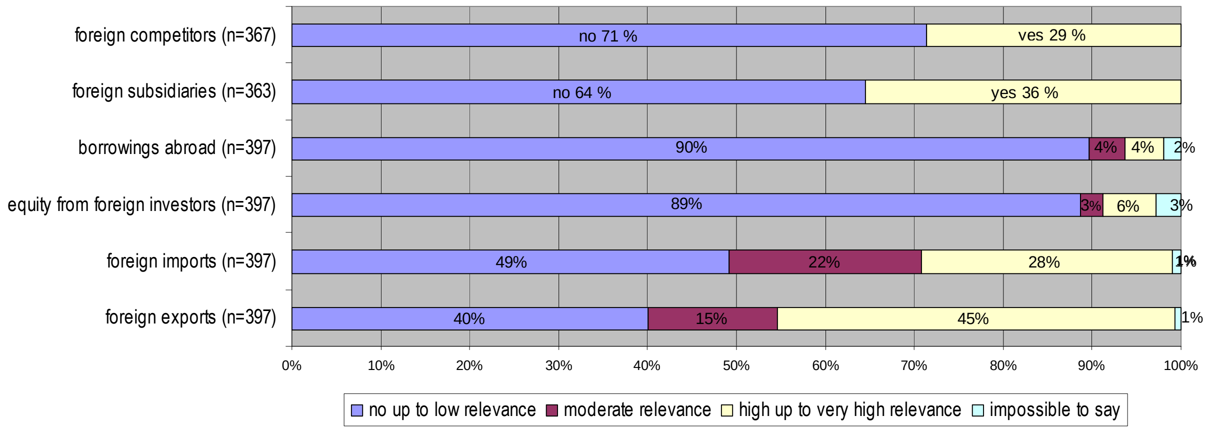

Figure 12: Cross-border activities

Question: **How relevant are the following foreign activities for your entity (or your group, if your entity is a parent company which prepares consolidated financial statements)?**

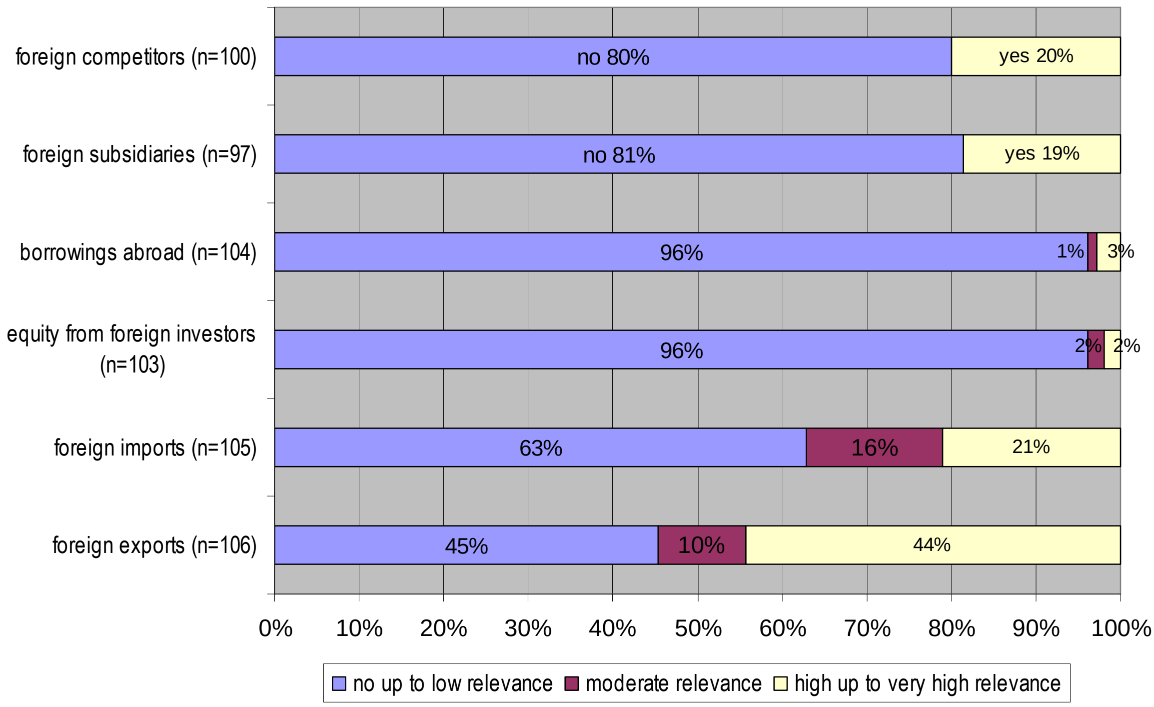

Figure 13: Cross-border activities of entities with annual sales of 8-32 m EUR

Question: **How relevant are the following foreign activities for your entity (or your group, if your entity is a parent company which prepares consolidated financial statements)?**

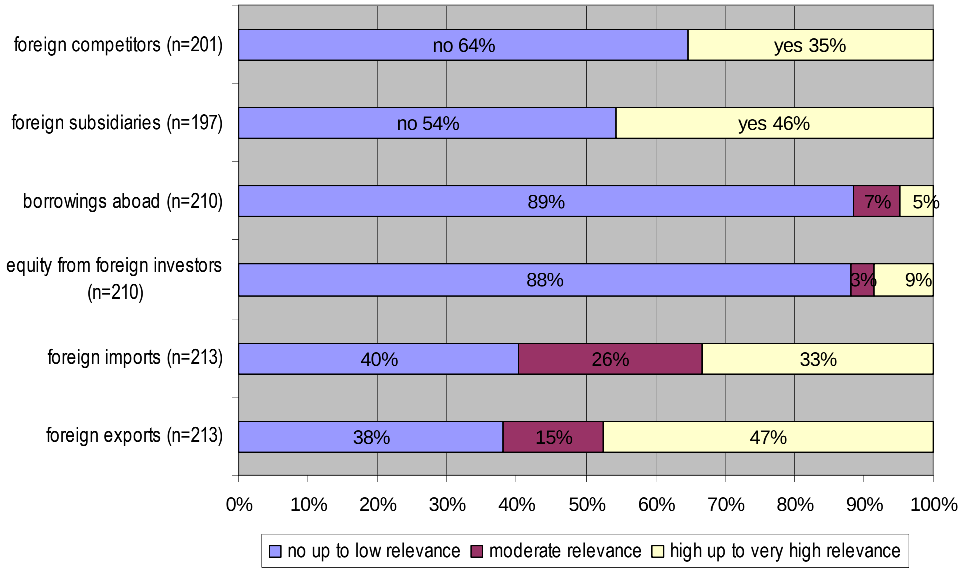

Figure 14: Cross-border activities of entities with annual sales higher than 50 m EUR

The entities were also asked about their foreign currency transactions. Without an obvious size effect 32% of the entities stated they had purchases, and 26% stated they had sales in a foreign currency (see figure 15). These answers reveal that quite a considerable number of companies have transactions with partners outside of the Euro-zone.

Question: **How often do the following foreign currency transactions arise in your entity?**

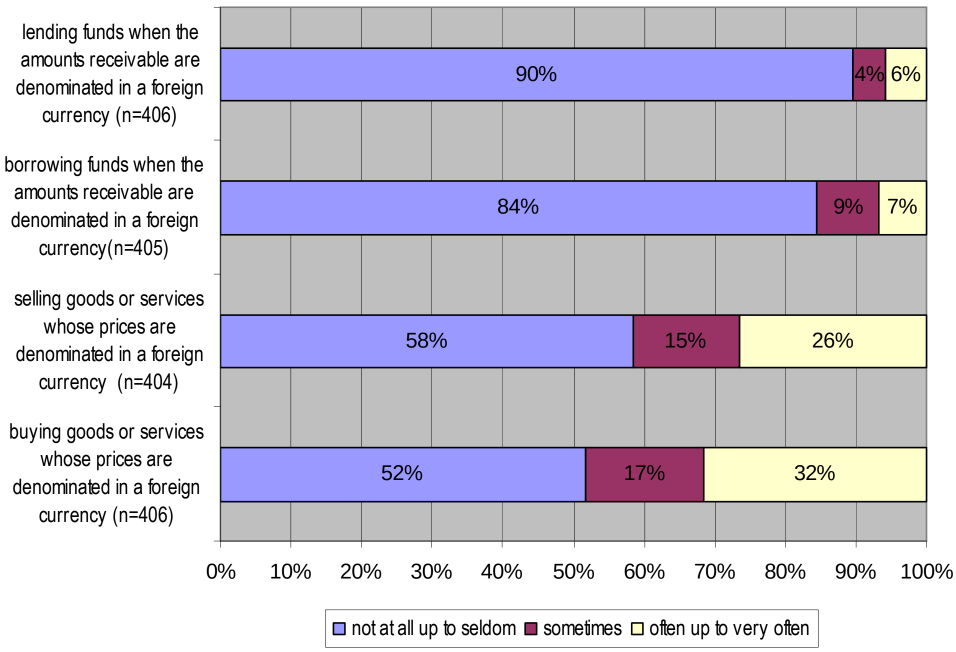

Figure 15: Foreign currency transactions

With regard to the relation between cross-border activities and the objectives and addressees of financial reporting it must be considered that although imports and exports of goods and services seem to be common activities of SMEs, only very few of the entities regard vendors (7%) or customers (6%) as highly (important) users of their separate financial statements (13% and/or 8% concerning consolidated statements) (see figures 9 und 10).

In total, a need for internationally comparable financial reporting standards does not obviously seem to result from the cross-border activities of SMEs in Germany. However, such a need could be induced by being integrated in a group and/or by foreign competitors.

3.3 Need for global financial reporting standards

On the question as to whether the participating SMEs see a need for them to provide internationally comparable financial information, 48% entities stated that they do not see any need and 20% stated a little need. Only 12% indicated a (very) high need to provide such information (see figure 16).

Question: **How would you assess the need for your entity to provide internationally comparable financial information? (n=410)**

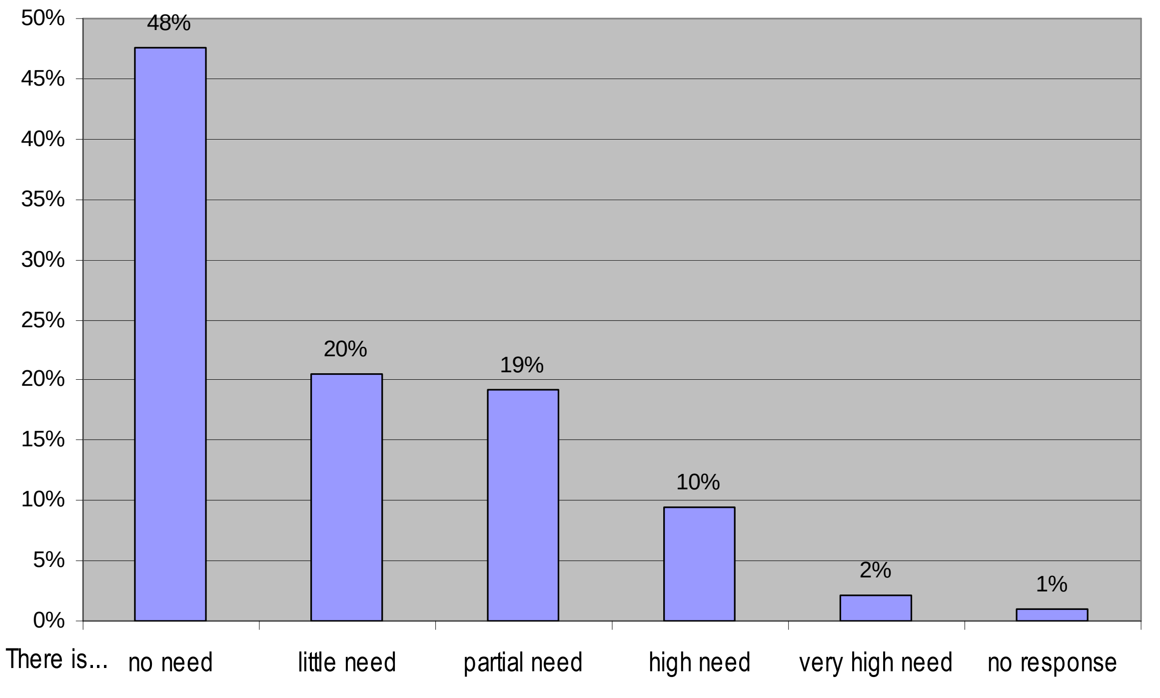

Figure 16: Need to provide internationally comparable financial information

Although this result might be regarded as a quite small proportion of entities in favor of internationally comparable financial information, it becomes obvious that the conceived need of such information is influenced by the extent of entities´ international activities. E.g. 18% of the entities with a high rate of exports (n=176) express a (very) high need of providing internationally comparable financial information, whereas this is only stated by 7% of the entities with a low export rate (n=156) (see figure 17).

Question: **How would you assess the need for your entity to provide internationally comparable accounting information? (n= 390)**

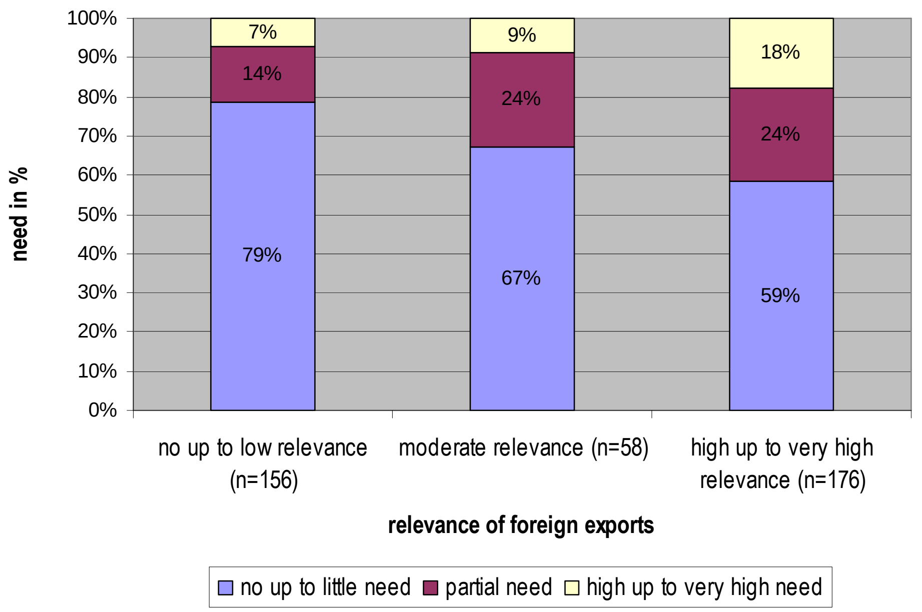

Figure 17: Need to provide internationally comparable financial statements information in relation to the rate of exports

Apart from the international activities, the size of the entity also seems to have an impact on the answers to the question about the need for globally comparable accounting data, as figure 18 shows.

Question: **How would you assess the need for your entity to provide internationally comparable accounting information? (n=402)**

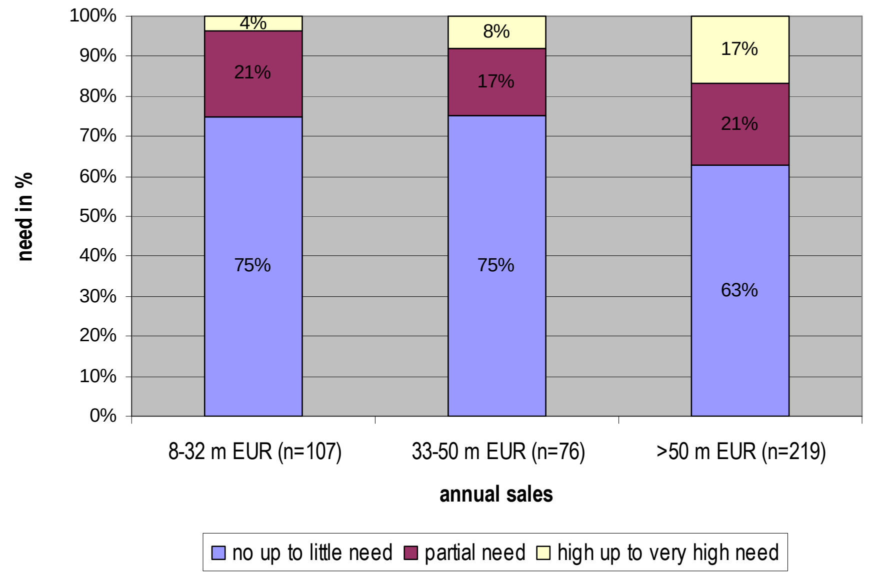

Figure 18: Need to provide internationally comparable financial statements information in relation to the annual sales

The 211 entities in total that stated a little (84), partial (79), high (39) and very high (9) need to provide internationally comparable financial information were asked to mention the expected benefits of such a provision, with multiple answers possible: Only 72 entities took the opportunity to answer this question. The most frequent answers were: comparability for business partners and within the group (24 answers), as well as comparability with competitors and within the same industry (17 answers). In particular, benefits are primarily seen by entities that are members of a group (17 answers) or which expect advantages in the raise of capital (10 answers). Higher transparency (8 answers) and more realistic information on the economic condition of the entity are further benefits mentioned.

These results show that the entities see more or less the same benefits of internationally comparable financial information as the IASB mentions in BC15 and 16 of the ED-IFRS for SMEs.

4 QUESTIONS ABOUT THE ED-IFRS FOR SMES

4.1 The standard as a stand-alone document

At the beginning of the standard-setting process the IASB saw merit in two approaches: publishing the standard in a separate volume or integrating separate SME-specific sections in each of the IFRS. It therefore asked the public in its 2004 Discussion Paper which of the two concepts should be seen as favorable.[6] The majority of the respondents to the Discussion Paper favored the first one (ED-IFRS for SMEs BC123) because it was perceived to facilitate the application and practicability of the rules for SMEs. For this reason, right from the beginning of the standard-setting process the concept and objective of the stand-alone standard has had a high priority.

This objective of a stand-alone document is constrained by multiple references to the full IFRS in the ED-IFRS for SMEs. These references are used in the ED in order to give guidance to the SMEs in all cases of issues not typical or relevant for SMEs and therefore not explicitly regulated in the SME standard (e.g. segment reporting or the treatment of a finance lease in the financial statements of the lessor). This handling of issues, which the IASB supposes to occur rarely in an SME, helps on the one hand to keep the number of pages (volume) of the standard down, while on the other hand, those entities that are confronted with such issues have to apply the full IFRS. In addition to this, the IASB had decided in principle to pass all the accounting options of the full IFRS also to SMEs.[7] In most of those cases – again to keep the volume and the complexity of the standard down – the IASB has chosen to regulate the accounting alternative of the option, which is perceived to be the easier (less complex) one, in the SME standard explicitly, and refer to the full IFRS for the other alternative. The IASB came to the conclusion that although this would restrict comparability, SMEs would not be treated in a more disadvantageous way than other entities applying the full IFRS. Also the transfer to the full IFRS would be eased. However this is a challenge for SMEs, because they have to evaluate the attractiveness and feasibility of the application of the particular accounting method, and have to keep up with all changes in the full IFRS occurring over the years to judge the advantageousness of the application of particular

[6] See IASB (2004) Discussion Paper, pp. 34-35 and 41; see for the responses www.iasb.org.

[7] An exception is Section 27 'Employee benefits' which does not include all options of IAS 19 with regard to the treatment of actuarially gains and losses.

methods in the future. The IASB still considers this issue very important for the development of the standard and therefore addresses two precise questions on it in the ED (question 6 concerning issues relevant for SMES and question 4 concerning the options).

Against this background, the survey covered these issues in asking which transactions and issues occur relatively rarely in SMEs and must therefore not be treated explicitly in the SME standard, and how the participants appreciate the accounting options included in the ED.

4.1.1 Relevance of specific accounting-related topics for SMEs

According to the above-mentioned concept of the IASB, which underlies the development of the IFRS for SMEs, the ED aims to address only topics that are of general relevance for SMEs and not to explicitly regulate issues and transactions which do not usually occur in SMEs. In cases where a SME encounters transactions or other events or conditions that are not regulated in the ED, the IASB does not require a direct reference to full IFRS for a solution, but the selection of an accounting policy that results in relevant and reliable information. In making that judgment, an entity should consider, first, the requirements and guidance in the IFRS for SMEs dealing with related issues, and second, the definitions and pervasive principles in Section 2 of the ED. If that does not provide appropriate guidance the entity may look to full IFRS or recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, or even at other accounting literature and accepted industry practices, if these do not conflict with the rules of the IFRS for SMEs (ED-IFRS for SMEs 10.3.-.4).

In contrast to these cases of lack of explicit guidance in the IFRS for SMEs there is a direct reference to full IFRS for all topics that were excluded voluntarily by the IASB because they are supposed to be not generally relevant for SMEs (because they occur relatively seldom) or for all accounting alternatives related to policy options (see ED-IFRS for SMEs BC57); these are e.g. interim financial reporting, equity-settled share-based payment transactions, accounting for a finance lease by the lessor.

As the identification of transactions and circumstances that SMEs typically encounter is crucial for the cost/benefit consideration of the ED-IFRS for SMEs, the questionnaire included several questions investigating this issue (see figure 19).

Leases

Complying with the assumption of the IASB (ED-IFRS for SMEs BC62) it is quite rare that an SME is a lessor in a finance lease. Only 3% of the respondents stated that they act (very) often as a lessor in such a lease; 93% have never or very seldom acted as such. The answers are not obviously influenced by size. The necessity of referring to this issue in the IFRS for SMEs may therefore be questioned.

Sale of business units and discontinued operations

The same is true for the sale of a business unit and discontinued operations. Again without obvious differences in size, such events do not occur regularly in SMEs. 85% of the participants stated no or very little relevance of this issue. Only 1% of the respondents expressed a (very) high frequency of these events. This result may induce a rethinking of the necessity of the explicit regulation of this topic in Section 36 of the ED.

Research and development

On the other hand the survey also shows topics that SMEs encounter quite frequently. This is the case for research and development projects, which occur for 29% of the participating entities (very) often. This finding is more or less constant over the size clusters. This might be seen as a justification of an explicit regulation of this topic in Section 17 of the ED.

Construction contracts

Construction contracts also occur relatively frequently in SMEs. The survey shows 38% of entities that have these types of contracts often or even very often. Taking the group of entities with annual sales of 8-50 m EUR (n=141) the proportion of this high frequency is, at 45%, even higher. These findings may be regarded as a justification of the ruling in Section 22 of the ED.

Question: How often do the following issues occur in your entity?

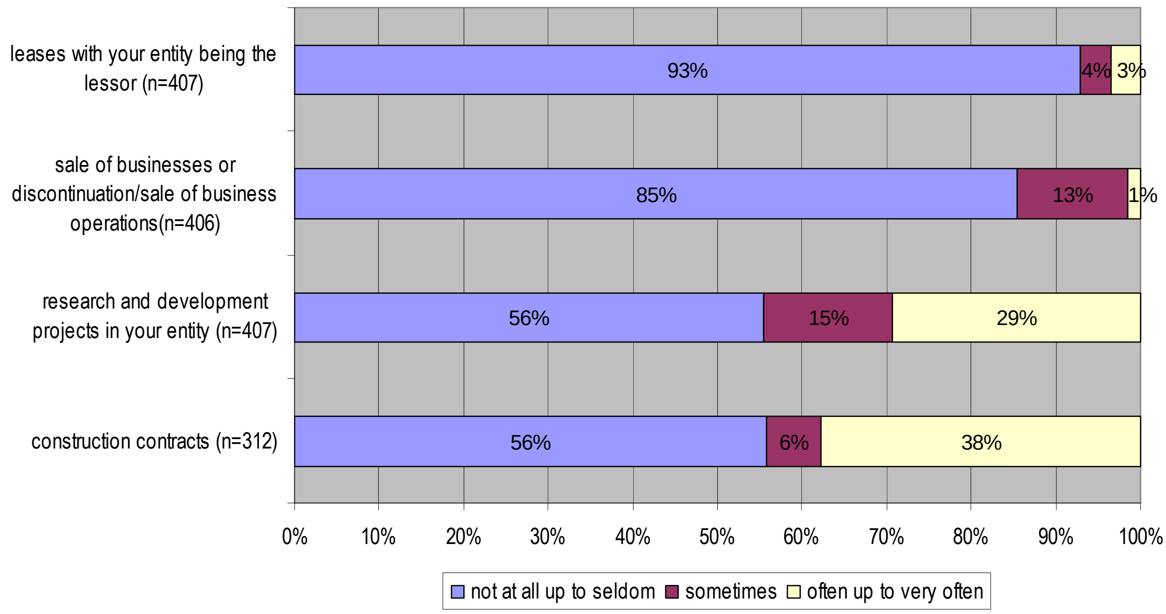

Figure 19: Frequency of particular issues in SMEs

Share-based payment

Another explicitly regulated topic in the ED is share-based payment. However, the rules cover in detail only cash-settled share-based payment transactions. For equity-based transactions and those with cash alternative, Section 25 of the ED-IFRS for SMEs refers to IFRS 2.

Compared with the other types of share-based payment the cash-settled type seems to be the one that is most frequently used in SMEs, albeit still on a very low level. 19% of the respondents stated that this form of compensation is of moderate (11%) or (very) high (8%) relevance (see figure 20). The vast majority of the entities responded that share-based payments do not occur at all or occur very seldom. The results suggest that the explicit regulation of this topic may be questioned.

Required assessment: **Please indicate the relevance of the following types of share-based payment in your entity (n=410).**

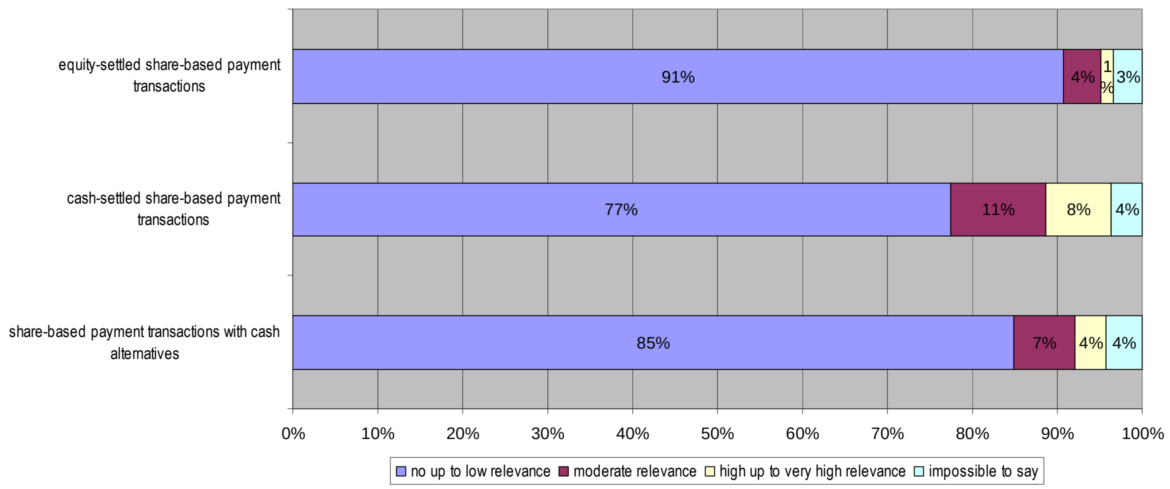

Figure 20: Relevance of share-based payment

Hedge transactions

The rules for hedge accounting were one of the topics of major concern to the IASB. Due to the complexity of the provisions of IAS 39, considerable simplifications were considered to be necessary. The IASB supposed that only a few hedge instruments are used by SMEs and therefore that it would be sufficient to restrict the ED to the hedge of only some specific risks which are mentioned in Section 11.31. This provoked questions in the questionnaire as to whether SMEs really do hedge those risks mentioned, and to what extent. The answers reveal that foreign currency exchange risks are the most frequent reasons for hedge transactions (see figure 21). 21% of the entities indicate that those risks are hedged frequently or very frequently. However a size effect becomes obvious; while exchange risks are also the most frequent reasons for hedging, the frequency is considerably lower in entities with 8-32 m EUR of annual sales. Only 12% of this size cluster stated that these hedge transactions happen (very) frequently (see figure 22). This size effect is also – almost to the same extent – visible concerning all the other risks inquired (see figures 21 and 22), although on a much lower absolute level.

Question: **How often do transactions occur in order to hedge the following risks in your entity?**

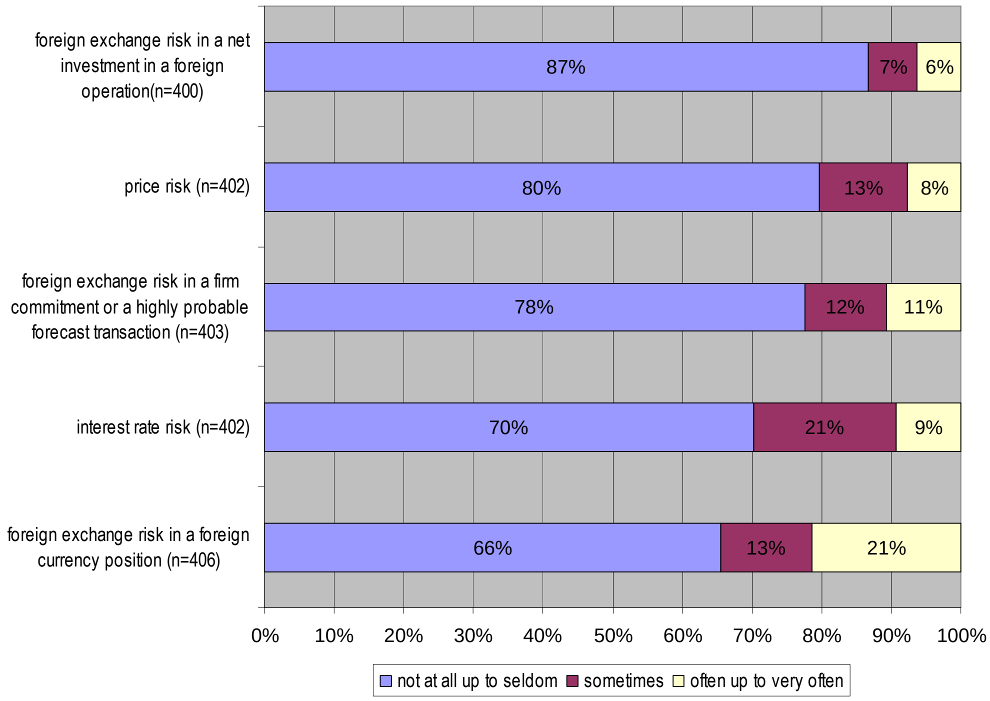

Figure 21: Frequency of particular hedge transactions

Question: **How often do transactions occur in order to hedge the following risks in your entity?**

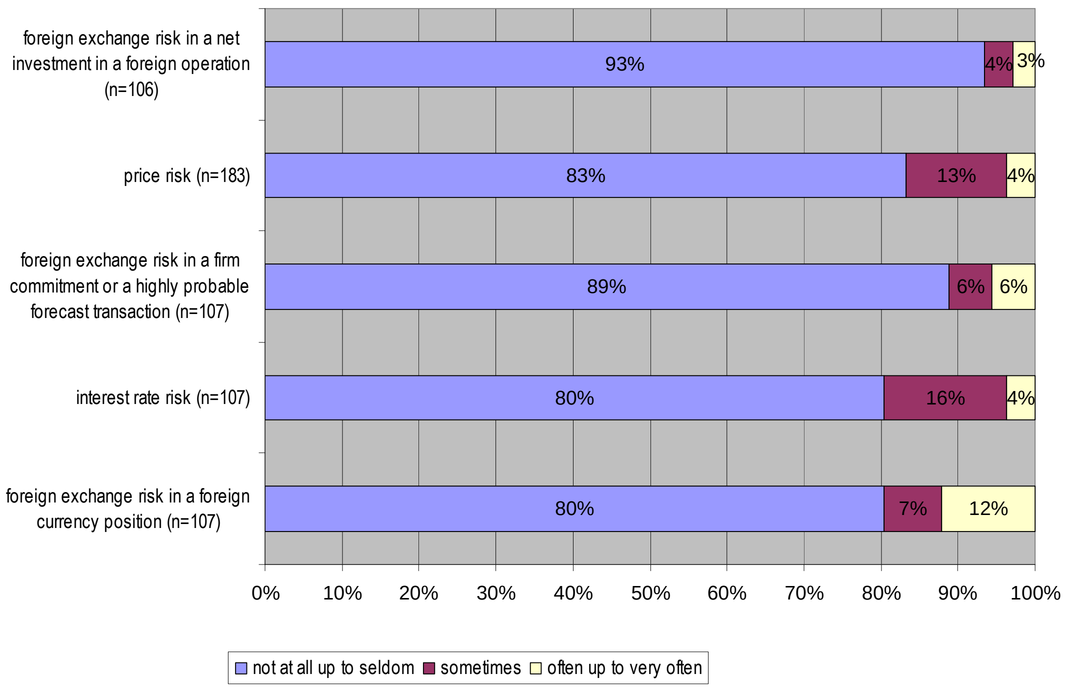

Figure 22: Frequency of particular hedge transactions in entities with annual sales of 8-32 m EUR

Acquisitions and goodwill

A topic in the ED that has been heavily discussed in the due process is the treatment of goodwill after recognition. Similar to IFRS 3 the IASB decided in favor of the "impairment only approach" and rejected the amortization of goodwill (ED-IFRS for SMEs 26.21 and BC80). Whether this issue, and the related question about higher costs related to the "impairment only approach" instead of amortizations, is really of relevance for SMEs depends not least on the frequency of acquisitions and business combinations in those entities.

The survey shows clearly that acquisitions are a highly relevant topic for SMEs. More than half of the responding entities indicated that they had had at least one acquisition during the last ten years (see figure 23). The frequency of acquisitions is clearly related to the size of the entities. In the cluster of 8-32 m EUR of annual sales, 30 entities had 1-3 acquisitions during the last ten years, whereas in the cluster of more than 100 m EUR sales volume 27 entities had more than 6 acquisitions during the same period.

Question: **How many business acquisitions did your entity pursue over the last 10 years? (n=404)**

number of business acquisitions	size of the entity: annual sales				
	8-32 m EUR	33-50 m EUR	51-100 m EUR	>100 m EUR	total
0	77	35	52	45	209
1-3	30	35	29	43	137
4-6	1	4	6	12	23
>6	0	2	6	27	35
n	108	76	93	127	404

Figure 23: Number of acquisitions during the last 10 years

In order to evaluate the importance of goodwill in these acquisitions, the entities were asked whether the acquisitions usually resulted in a positive or negative goodwill. 60% of the entities answered "yes" to this question and only 13% said "no" (all the others did not make any statement or said that they were not able to answer to this question). This shows that goodwill accounting, and therefore the question of whether to use the "impairment only approach" or the "amortization approach", is an issue of considerable relevance for SMEs.[8]

Investment property, investment in associates or joint ventures, or other investments

As investments in associates and in joint ventures are explicitly regulated in the ED (Sections 13 and 14) the IASB expresses its conviction that these are usual transactions of SMEs. According to the results of the survey this conviction cannot be verified, because only 7% indicated a high and 8% a moderate relevance of investments in non-listed associates (the rates of investments

[8] For the respondents´ evaluations of the sensitivity of the required disclosure of the costs of an acquisition see chapter 4.3.

in listed associates were even lower; see figure 24).[9] The same picture can be drawn with regard to joint ventures that have a high or moderate relevance for 6% or 9% of the respondents. However in contrast to investments in associates, where the answers were quite stable over the different size clusters, a size effect is revealed with regard to joint ventures. While only 3% or 4% of the small size cluster (8-32 m EUR of annual sales) expressed a high or moderate relevance of this type of investment, these rates were 9% and 12% in entities with an annual sale of larger than 50 m EUR.

IASB´s conviction of relevance may also be qualified with regard to investment property, which is regulated in Section 15 of the ED-IFRS for SMEs. According to the survey, only 3% of the responding entities speak of a (very) high and 10% of a moderate relevance of this type of investment. Quite surprisingly, the rates where higher in smaller entities (8-32 m EUR annual sales) than these average figures: 4% mentioned a (very) high and 14% a moderate relevance. This may be due to the fact that in smaller firms the portion of sole proprietorships or partnerships may be higher, where it is more likely that assets are used partly in the business and partly for private purposes of the owner(s).

Question: **How relevant are – amongst others – the following types of investments with regard to the overall portfolio of your entity? (n=410)**

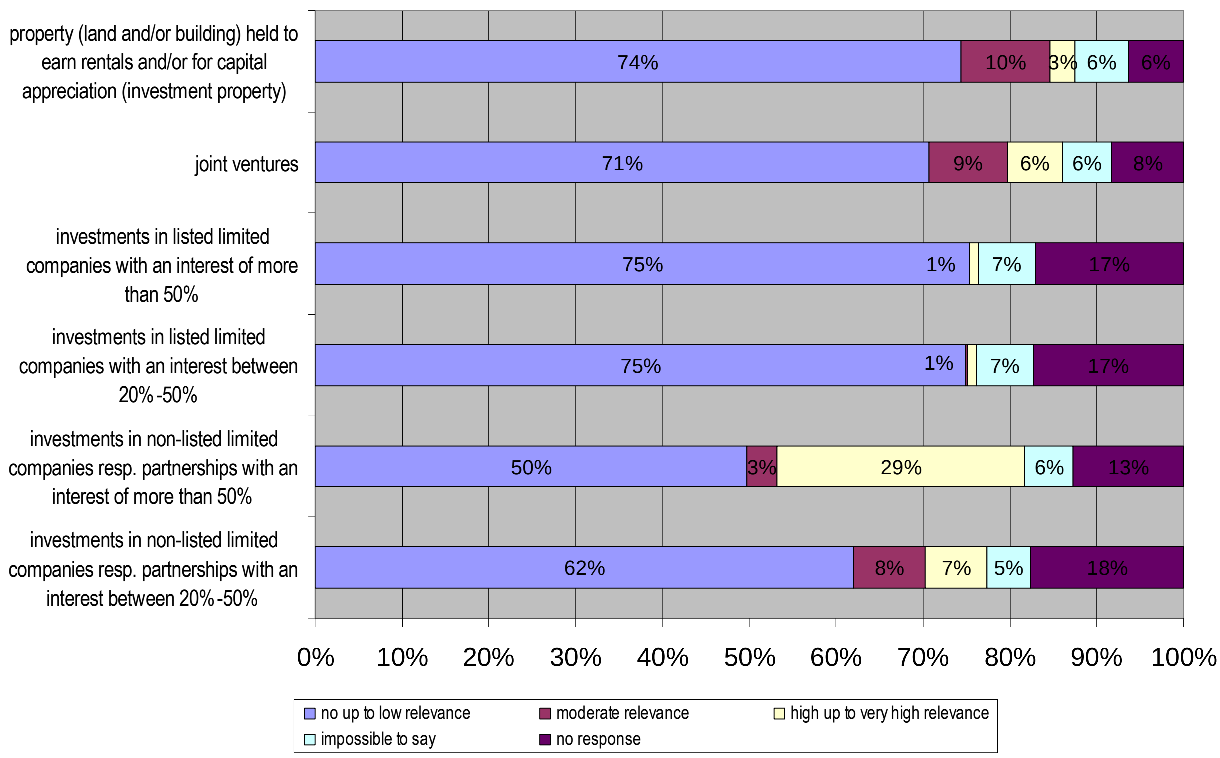

Figure 24: Relevance of particular types of investments

[9] For simplification and understandability reasons the participants were asked whether they have investments in other entities with an interest of 20%-50%, which is not totally identical to IASB´s definition of associates in ED-IFRS for SMEs 13.1.

Looking at figure 24 it is obvious that investments in non-listed entities with an interest of more than 50% play a considerable role that increases even with growing size of the entities (see figure 25). This reveals the above-mentioned financial integration of SMEs, which is much more extensive with respect to majority ownerships (interest over 50%) than with associate relationships (interest between 20% and 50%), a fact which seems to be true for all size clusters. The responses of the survey show also the low relevance of investments in listed companies by SMEs.

Question: **How relevant are – amongst others – investments in non-listed limited companies and/or partnerships with an interest of more than 50% with regard to the overall portfolio of your entity? (n=355)**

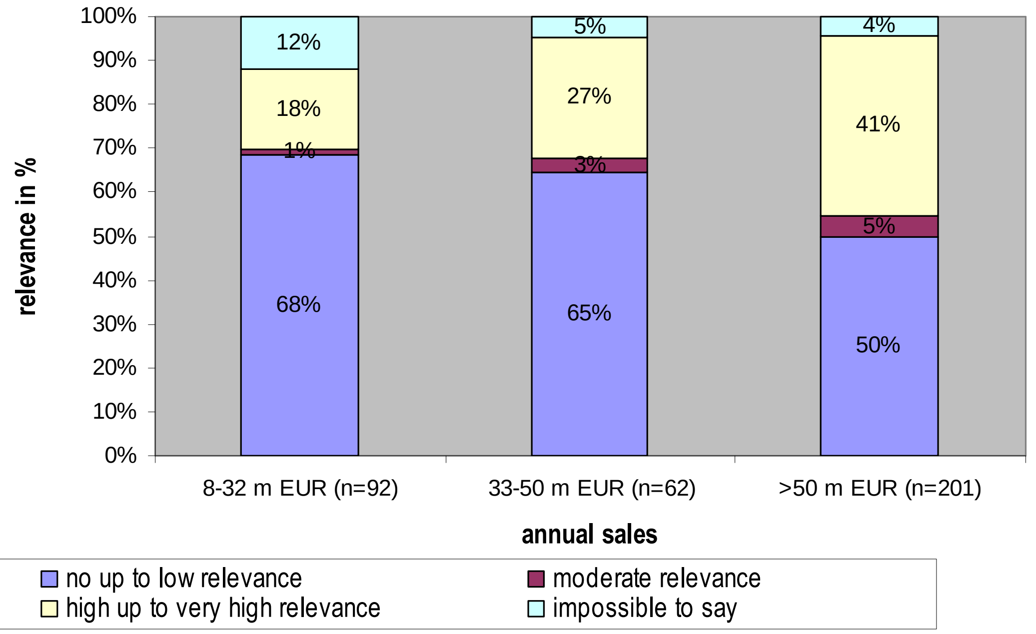

Figure 25: Relevance of investments in non-publicly traded companies and/or partnerships with an interest of more than 50% in relationship with annual sales

Employee benefit plans

Similarly to IAS 19 the ED-IFRS for SMEs differentiates between defined benefit and defined contribution pension plans. As illustrated in figure 26, 31% of the respondents expressed a high or very high relevance of defined contribution plans, while 19% indicated a moderate relevance. Comparatively less relevant seem to be defined benefit plans. There are assessed as of (very) high relevance by 18% and of moderate relevance by 25% of the entities. The findings are more or less constant over the investigated size clusters.

In a nutshell it appears that although employee benefit plans are of no or very little relevance to approximately half of the SMEs included in the survey, it is obvious that this accounting issue is important enough – at least for German SMEs – to be dealt with in the IFRS for SMEs.

Question: **How relevant are the following aspects for your entity (relative to total assets)?**

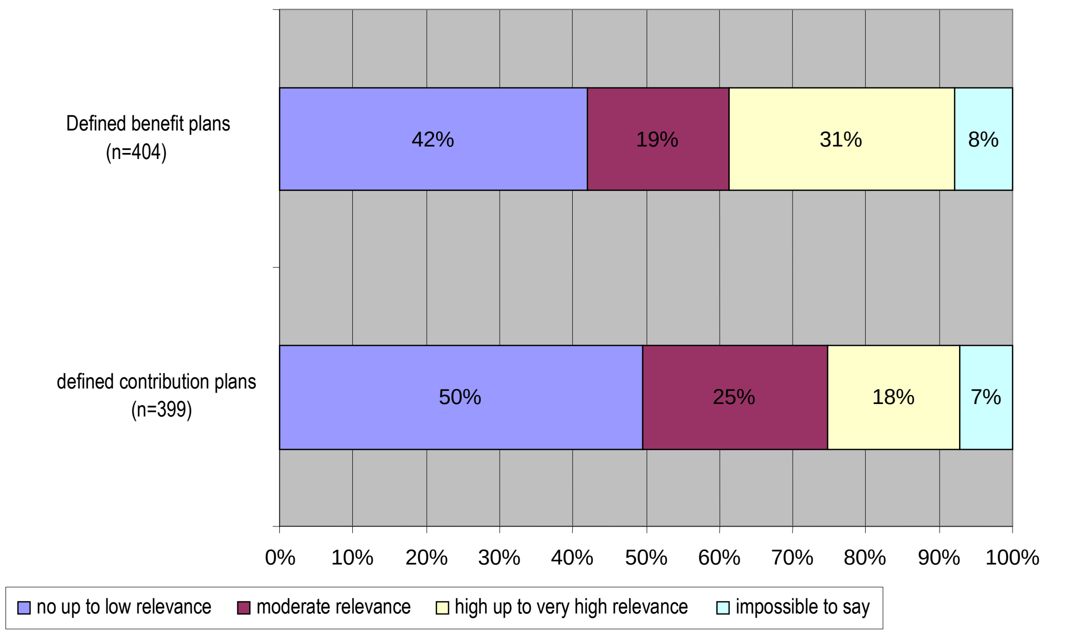

Figure 26: Relevance of employee benefit plans

4.1.2 Evaluation of accounting options

The development of the ED-IFRS for SMEs has mainly been influenced by IASB´s consideration of reporting entities´ expected costs as well as of financial statements´ users´ benefits of particular accounting methods; the needs of users have thus been regarded as paramount (ED-IFRS for SMEs BC23-26). Against this background the questionnaire aimed to investigate the preparers' assessment of the costs and the benefits, for both external and internal users (so to say for management and control purposes), of the financial information provided. As the assessment might be influenced by the consideration of the current German framework of tax and commercial laws which are still interlinked with regard to accounting, the participants in the survey were asked to answer the questions about accounting methods without such a consideration. With respect to accounting options the participants were asked to assess the revaluation option for property, plant and equipment (ED-IFRS for SMEs 16.11) and for intangible assets (ED-IFRS for SMEs 17.21), as well as the option to capitalize costs incurred in development activities (ED-IFRS for SMEs 17.14).[10]

Revaluation option of property plant and equipment

The respondents´ evaluation of the option to use the revaluation model for property, plant and equipment for subsequent measurements is quite equivocal (see figure 27). 28% assess it as favorable, almost the same number (25%) as unfavorable, and most of the respondents (40%) as neither nor. This varied evaluation is more or less constant over the different size clusters.

[10] There are several other options in the ED-IFRS for SMEs, such as: fair value option for investment properties, capitalization of capital cost, direct or indirect method to disclose operating cash flow in the cash flow statement, accounting for government grants either according to IAS 20 or according to the so-called "SME model"; for a categorization of the options included in the ED-IFRS for SMEs see *Haller/Beiersdorf/Eierle* (2007), p. 542.

However, the evaluation is different among respondents who assess their own knowledge of IFRS as good or very good (n=82); they evaluate the option in the majority as advantageous (39% advantageous, 22% as disadvantageous and 37% neither nor (see figure 28).

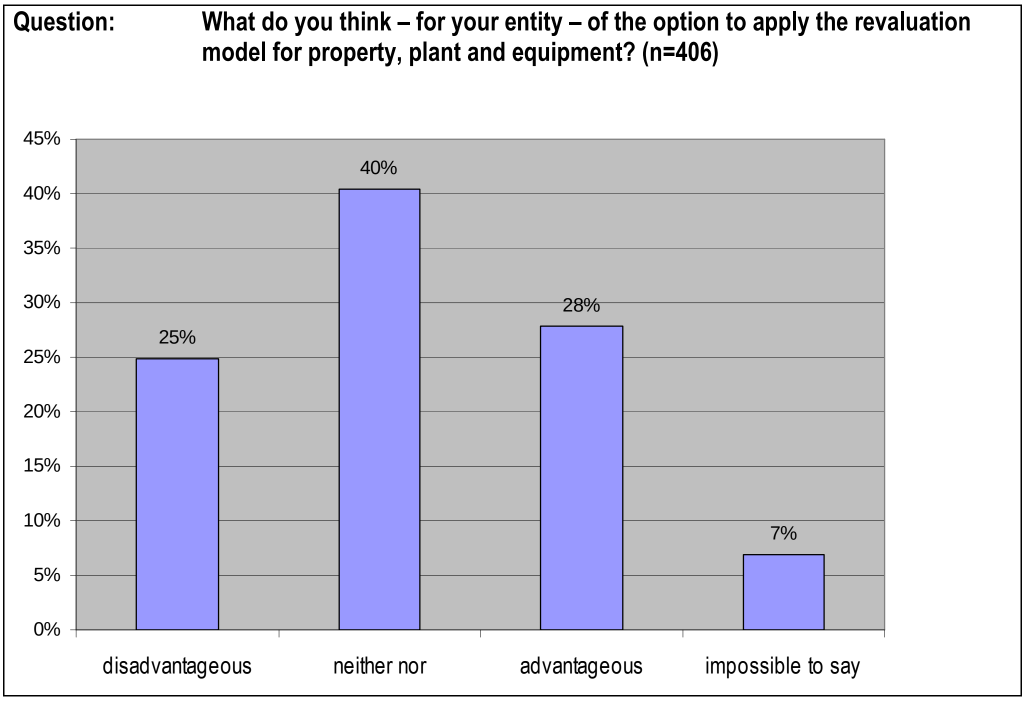

Figure 27: Evaluation of the revaluation option for property, plant and equipment

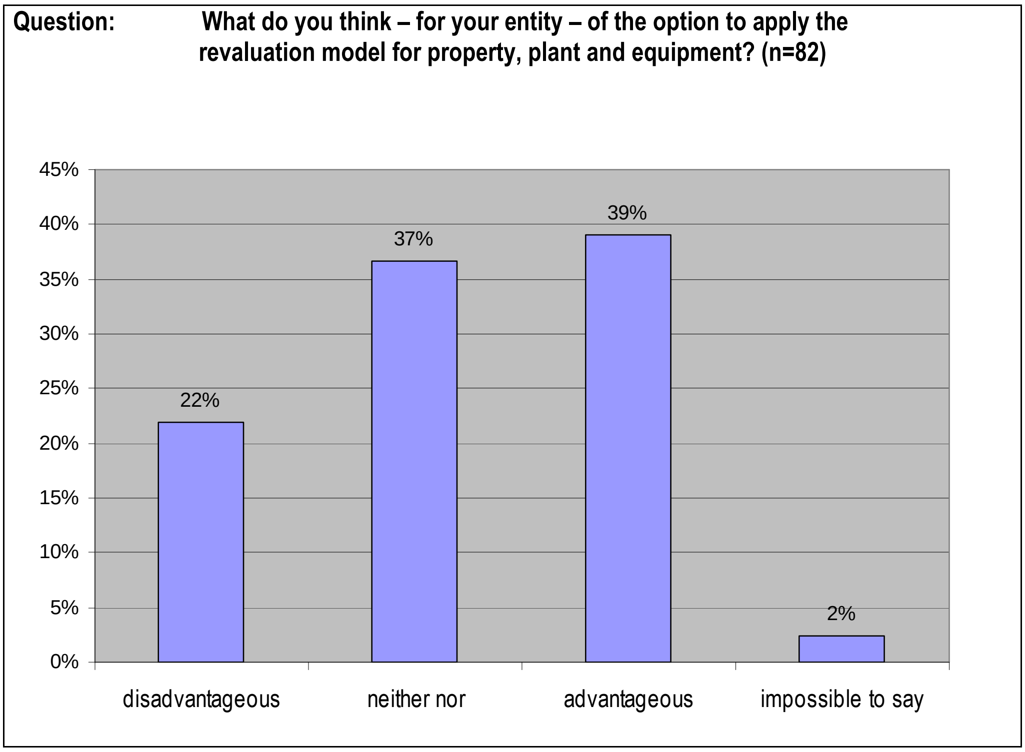

Figure 28: Evaluation of the revaluation option for property, plant and equipment by respondents who assess their knowledge of IFRS as (very) good

The participants were also asked to differentiate their evaluation according to the following two cases to calculate the revalued amount: market price exists ("marked to market") or the revalued amount has to be estimated by using appropriate valuation models ("marked to model"). Here the evaluation is less varied. In the case of "marked to market" the majority of respondents evaluate a larger benefit from the revaluation model than the cost model, both for external (52%) as well as internal (54%) information purposes (see figure 29). However, the cost related to the generation of the market value is also expected to be higher than by using the cost model.

Required assessment: **Please assess the revaluation model compared to the cost model with regard to the following criteria under the supposition that current market prices do exist:**

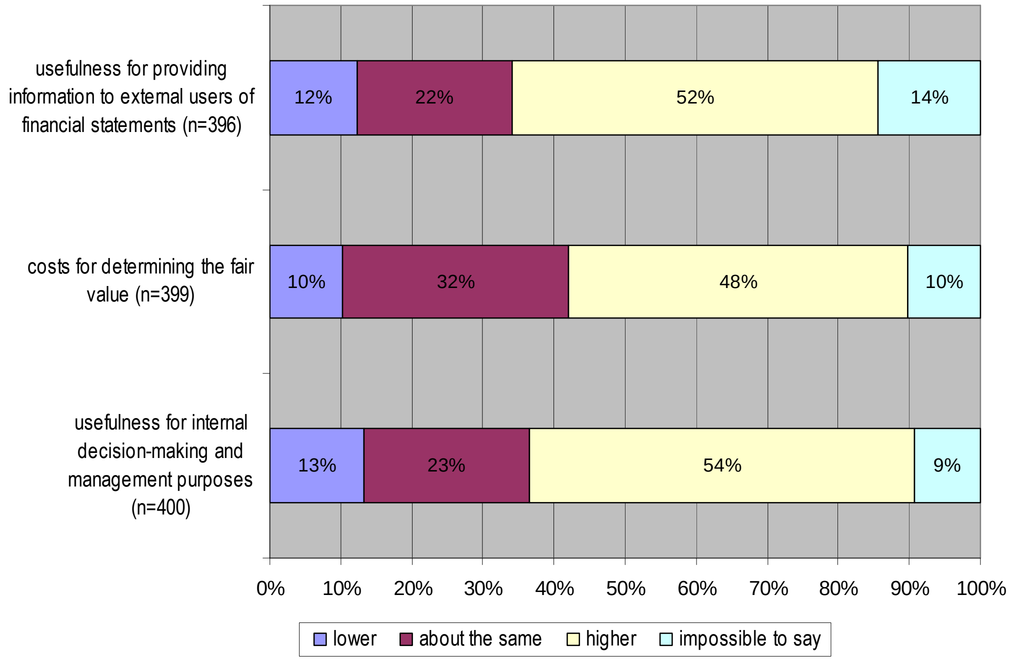

Figure 29: Evaluation of the revaluation option for property, plant and equipment with the supposed existence of a market price

Little benefit and high costs of the revaluation model are expected in the case of a marked to model valuation of the revalued amount (see figure 30). 33% of the respondents expect a lower benefit for external users and 38% for internal management and control purposes compared to the cost model, with 58% of entities assessing the measurement costs as being higher.

Required assessment: **Please assess the revaluation model compared to the cost model with regard to the following criteria under the supposition that current market prices do not exist and a fair value needs to be estimated:**

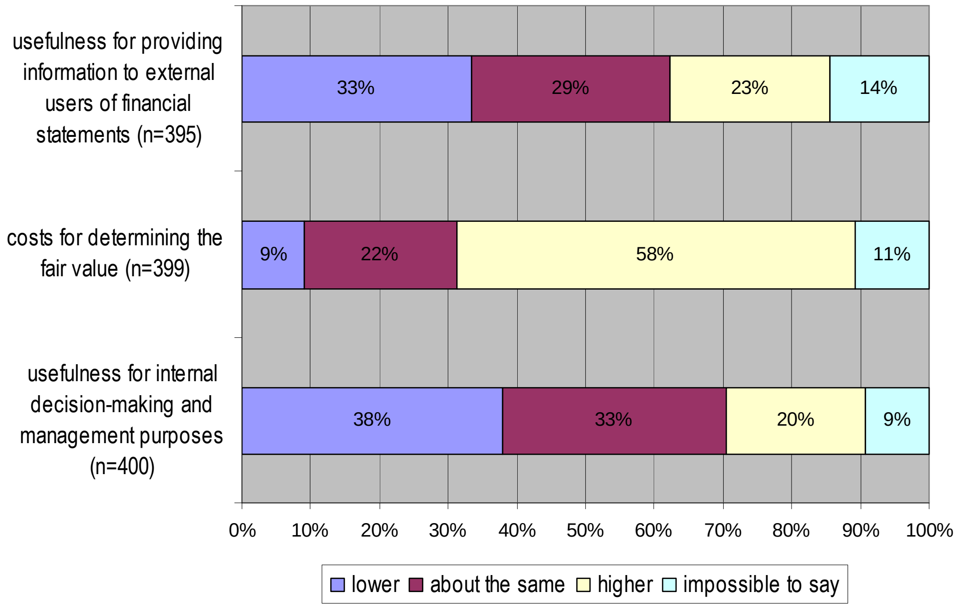

Figure 30: Evaluation of the revaluation option for property, plant and equipment with a supposed need to estimate the fair value

It can be concluded that the evaluation of the revaluation model for property, plant and equipment depends considerably on the existence of current market prices.

Revaluation option for intangible assets

Compared with the above, relatively more entities evaluate the option to use the revaluation model or the cost model for intangible assets as advantageous (see figure 31). 25% participants assess it as advantageous, only 14% see it as disadvantageous and 46% as neither nor. Like with property, plant and equipment, the evaluations differ only slightly between the size clusters. However, in contrast to the above assets the evaluation does not differ significantly between respondents with (very) good knowledge of IFRS (n=82) and all the others.

Required assessment: **What do you think – for your entity – about the option to apply the revaluation model for intangible assets? (n=402)**

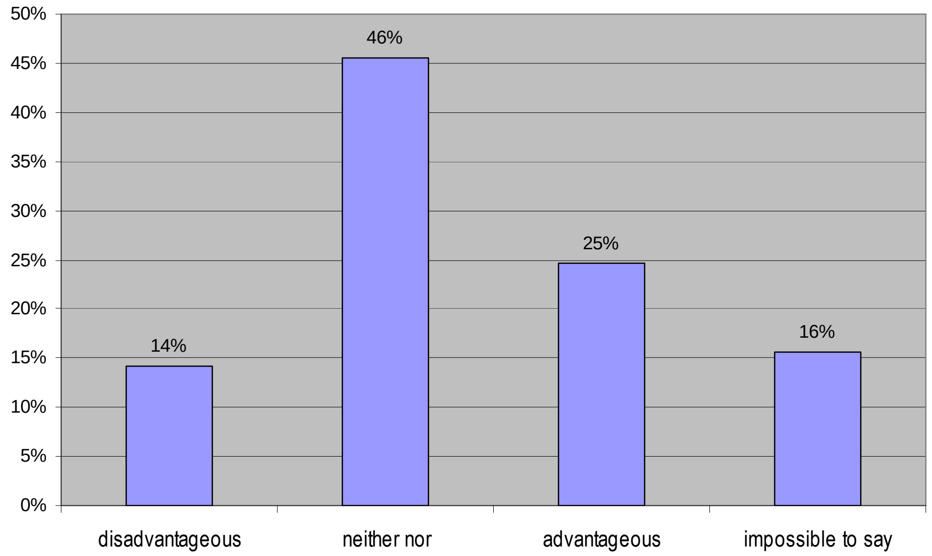

Figure 31: Evaluation of the revaluation option for intangible assets

Asked about the expected benefits for external and internal purposes and the costs, the revaluation model was assessed as being less beneficial for intangible assets than for property, plant and equipment. As figure 32 shows, 64% of the respondents expect higher valuation costs, whereas only 36% expect higher benefits for external and 31% for internal purposes. However many entities expect neither a higher nor a lower benefit of the revaluation model compared with the cost model.

Required assessment: **Please assess the revaluation model compared to the cost model with regard to the following criteria:**

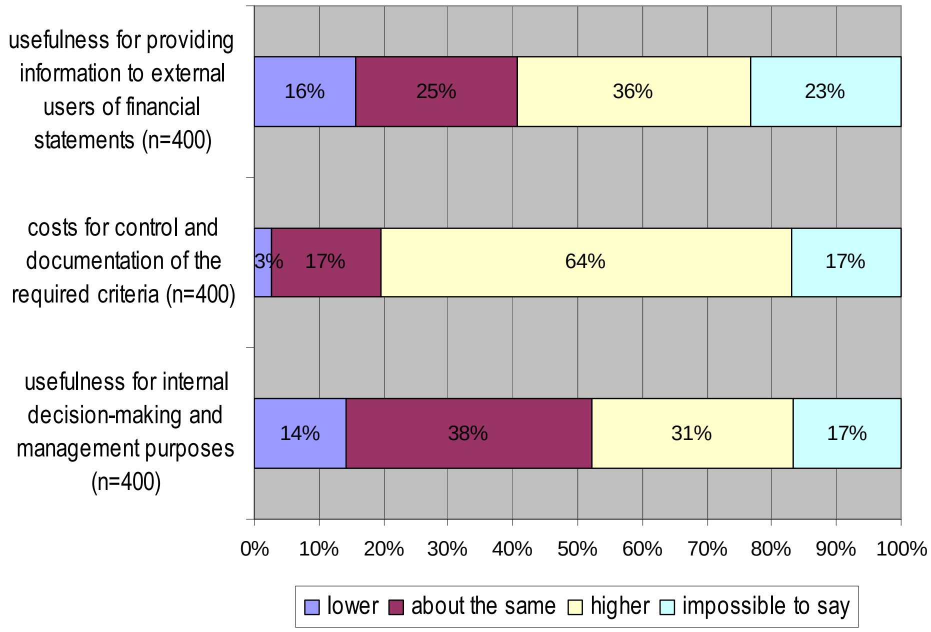

Figure 32: Evaluation of the revaluation option for intangible assets according to expected costs and benefits

With regard to intangible assets a size effect is obvious. Larger entities (> 50 m EUR of annual sales) evaluate the benefits for external users as well as the valuation costs higher than medium sized entities (see figures 33 and 34). The benefit for internal purposes is evaluated approximately similarly in each size cluster, although the entities with 51-100 m EUR annual sales hardly ever express a lower benefit from the revaluation model compared to the cost model.

Required assessment: **Please assess the revaluation model compared to the cost model with regard to the usefulness for providing information to external users of financial statements: (n=396)**

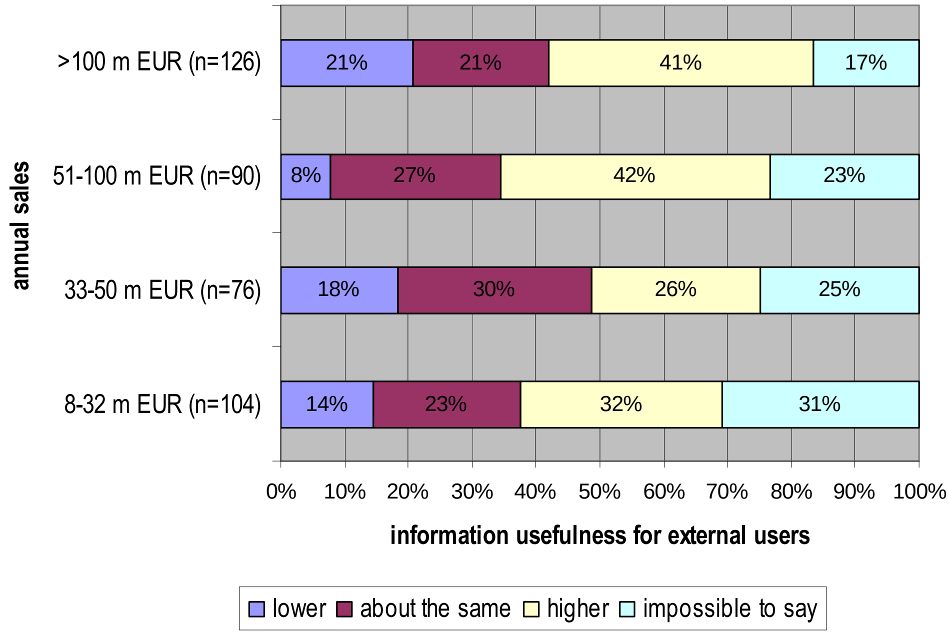

Figure 33: Evaluation of the revaluation option for intangible assets according to the expected benefits for external users in relation with annual sales

Required assessment: **Please assess the revaluation model compared to the cost model with regard to the valuation costs of the entity: (n=396)**

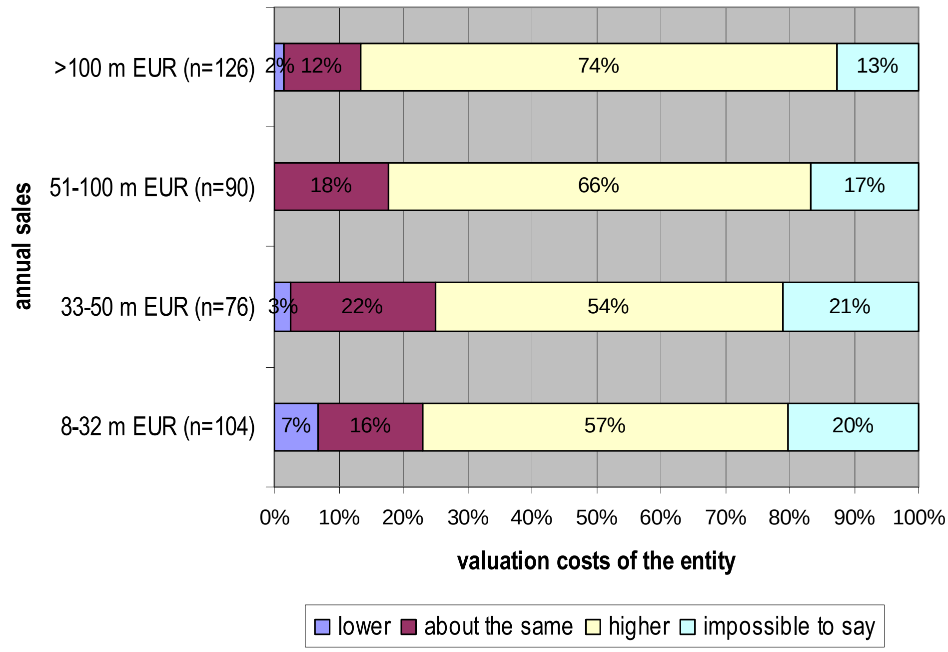

Figure 34: Evaluation of the revaluation option for intangible assets according to the expected costs in relation to annual sales

Option to capitalize costs incurred in development activities

In Section 17.14 of the ED the IASB proposes an option to capitalize costs incurred in development activities, if they comply with the criteria outlined in IAS 38.51-67. These are:

- technical feasibility of completing the intangible asset,
- intention to complete the intangible asset and use or sell it,
- ability to generate probable future economic benefits,
- availability of adequate technical, financial and other resources to complete the development,
- ability to measure reliably the attributable expenditures of the development.

29% of the entities in the survey evaluate this capitalization option to be advantageous and 10% to be disadvantageous, 42% neither nor. Figure 35 shows that 41% of the entities expect, from recognizing the development costs as expense of the period, a higher and 20% at least the same benefits for external users compared to capitalization. Also, the benefits for internal management and control purposes are expected to be higher (36%) or the same (32%). Only a few entities assess lower benefits for external (13%) and internal (10%) information purposes compared to the recognition as expense. These findings must be related to the answers concerning the evaluation of the costs incurred by the required measures of documentation and control. 58% assess those costs as higher than the costs incurred by using the expense model. However, a quite high proportion of more than 20% of the entities stated that they are unable to make the required evaluations.

Required assessment: **Please assess the capitalization of development costs compared to the recognition of development costs as expense with regard to the following criteria:**

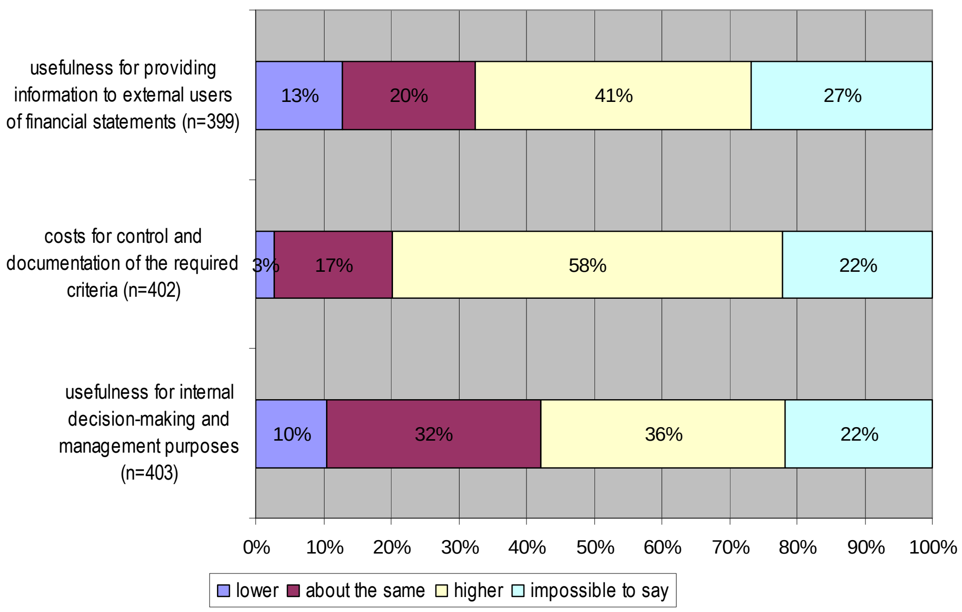

Figure 35: Evaluation of the capitalization of development costs compared to the recognition as expense

Differentiated by size, the survey reveals that the benefits for external and internal purposes are assessed as being positive by all sizes investigated; even entities of the small size cluster express a higher or at least the same benefit of the capitalization model compared with the expense model (see figures 36 and 37). A smaller benefit of the capitalization model is only seen by 9% of the entities of the cluster of 8-32 m EUR of annual sales, whereas 16% of the entities of the largest size cluster (> 100 m EUR annual sales) share this view. With increasing size the proportion of entities which expect higher costs of the capitalization model also rises (see figure 38). An additional analytical insight is given when the assessments are controlled for the IFRS knowledge of the respondents. Among the people with (very) good IFRS knowledge (n=82) the proportion of those that assess the benefits and costs comparatively higher is larger than with regard to all the respondents. 51% expect a higher benefit for external users and 44% for internal purposes, and 63% expect higher costs of the capitalization model compared to the expense model.

Required assessment: **Please assess the capitalization of development costs compared to the recognition of development costs as expense with regard to the usefulness for providing information to external users of financial statements: (n=395)**

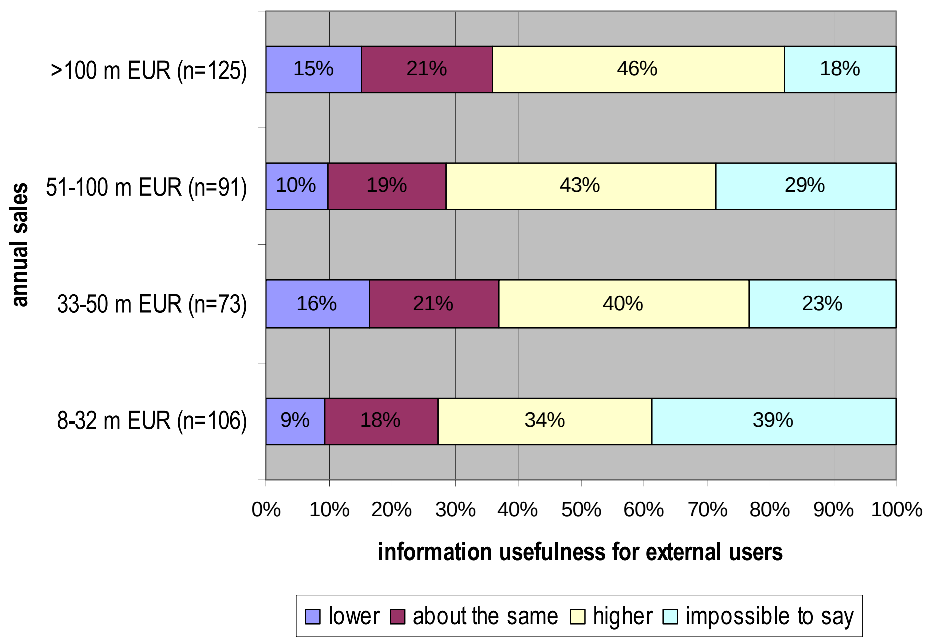

Figure 36: Evaluation of the capitalization of development costs compared to the recognition as expense with regard to the information usefulness for external users in relation with annual sales

Required assessment: **Please assess the capitalization of development costs compared to the recognition of development costs as expense with regard to the usefulness for internal decision making and management purposes: (n=399)**

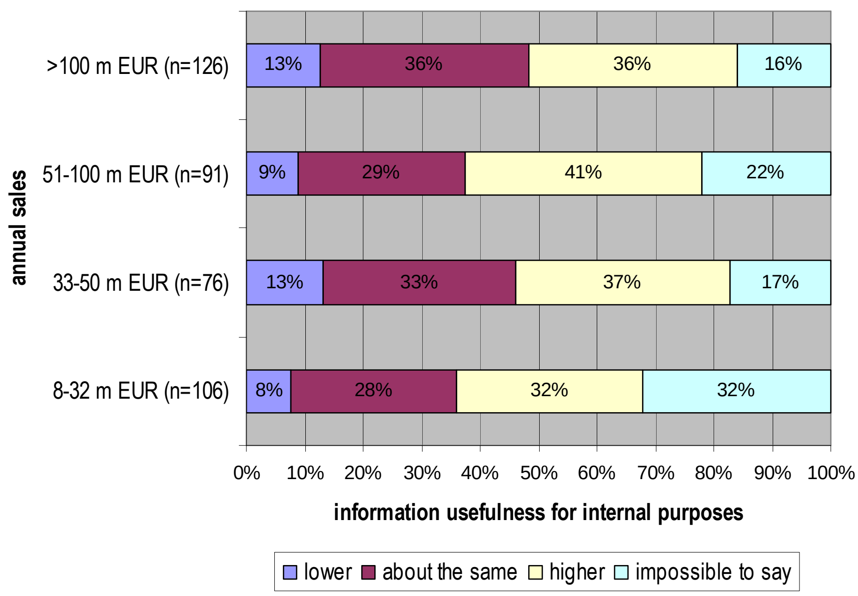

Figure 37: Evaluation of the capitalization of development costs compared to the recognition as expense with regard to the information usefulness for internal purposes in relation with annual sales

Required assessment: **Please assess the capitalization of development costs compared to the recognition of development costs as expense with regard to the costs for control and documentation of the required criteria: (n=398)**

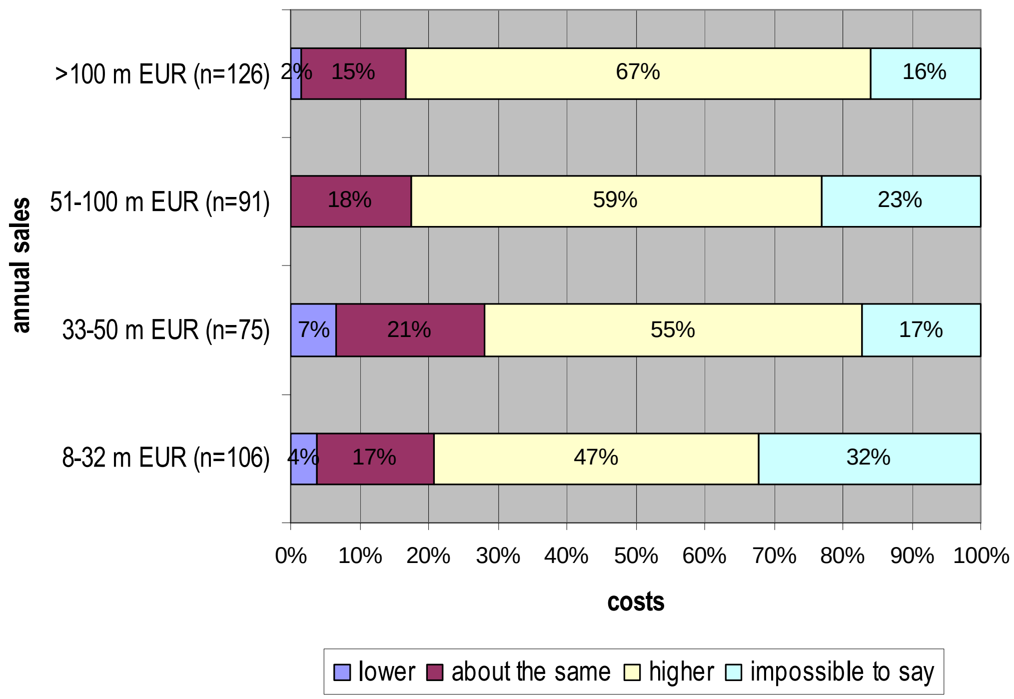

Figure 38: Evaluation of the capitalization of development costs compared to the recognition as expense with regard to the costs in relation with annual sales

In total the survey seems to show that SMEs evaluate the benefits as well as the related costs of the capitalization model higher than the expense model.

4.2 Evaluation of particular accounting issues

In the questions about the evaluation of the cost and benefits of particular accounting topics, especially those issues were selected that are expected to be of high relevance for SMEs (those that occur regularly; e.g. property, plant and equipment, inventories and provisions) and/or that have been discussed quite controversially during the development of the ED (e.g. deferred taxes and pension accounting). Looking at the following answers it must be kept in mind that also in this context (like in chapter 4.1.2), the respondents were asked not to consider the current German legal framework of tax and commercial laws.

4.2.1 Accounting for property, plant and equipment

The IASB requires in ED-IFRS for SMEs 16.14 that an "entity shall allocate the amount initially recognized in respect of an item of property, plant and equipment to its significant parts and depreciate separately each such part." The participants were asked to evaluate this components approach of depreciation compared with just one depreciation charge for the entire item. Figure 29 shows that the external and internal benefits of a separated depreciation of an item is not evaluated higher than a non-separated one (19% see a higher benefit for external and 27% a higher benefit for internal uses, whereas 28% asses a lower benefit for external and 30% a lower benefit for internal uses). Approximately a third of the respondents assess it as being of equal benefit. However, 74% of the respondents expect the costs to be higher with the components approach. There is no material difference in the answers of the entities of the group of 8-32 m EUR of annual sales.

Required assessment: **Please evaluate the component approach compared to a uniform depreciation for all components with regard to the following criteria:**

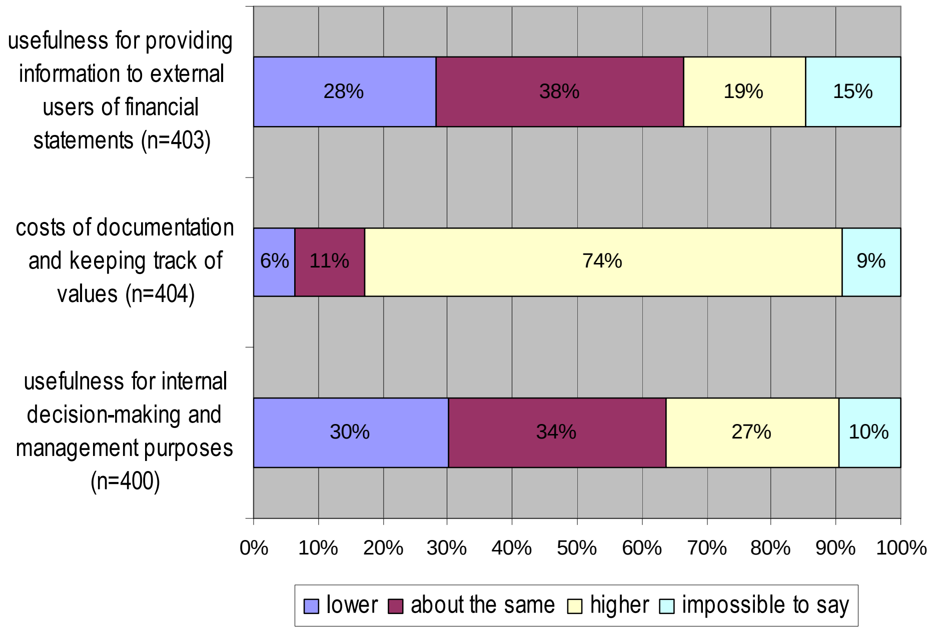

Figure 39: Evaluation of the components approach

In Section 36 of the ED the IASB requires that a non-current asset is not depreciated while it is classified as held for sale. Those are assets which are supposed to be sold within one year after balance sheet date. Such an asset is measured at the lower of its carrying amount and fair value less costs to sell. 52% of the respondents regard this treatment as beneficial for external users of financial statements and 33% do so for internal purposes. At the same time, 62% express their concern about the sensitivity of this information and 56% stress the higher costs (see figure 40). Overall this view is shared by respondents within the group of 8-32 m EUR of annual sales, although they state more often than the others that they are unable to make an assessment.

Required assessment: **Please assess the specific treatment for "non-current assets held for sale" compared to accounting under German GAAP (no separate classification, continuing depreciation) with regard to the following criteria:**

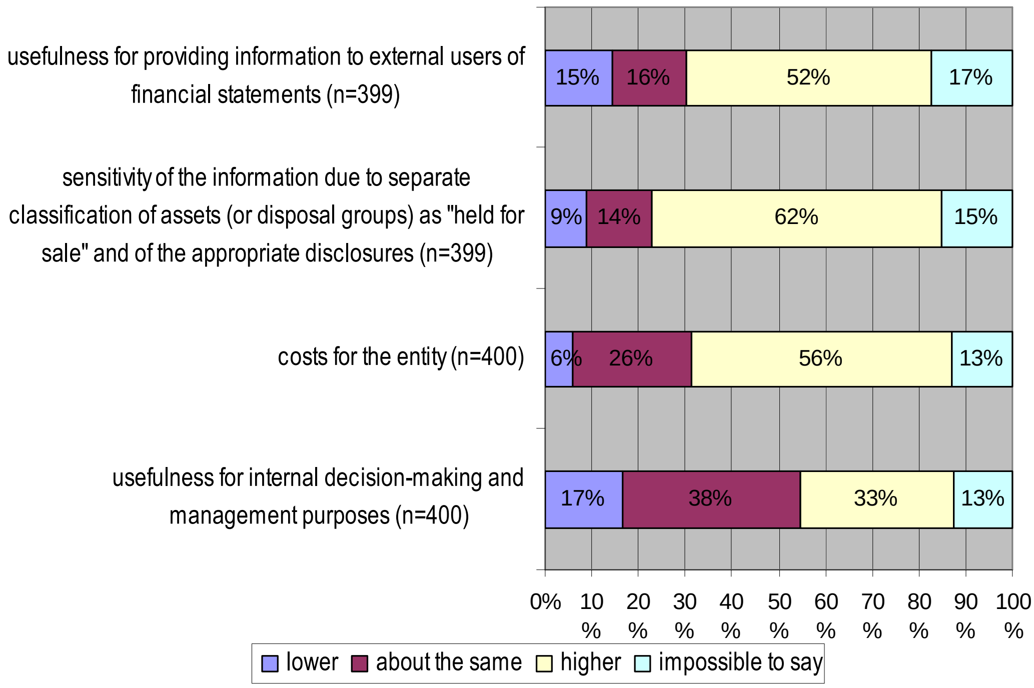

Figure 40: Evaluation of the specific treatment of non-current assets classified as held for sale

4.2.2 Accounting for deferred taxes

Quite often the statement can be heard that the recognition of deferred taxes causes high costs in the entities but insufficient benefit for the users.[11] This might be the reason for the EU Commission's proposal to rethink the reasonableness of the recognition of deferred taxes for small companies in the revision of the EU accounting directives currently under discussion.[12]

The participating entities do not have the same view on the question of the benefits of the recognition of deferred taxes. As figure 41 shows, 30% of respondents state a (very) high benefit for external information purposes, whereas 26% express a lower external benefit. Concerning internal purposes, 27% mention a (very) high benefit, whereas the proportion of people stating no or a low benefit is at 35% larger. Looking at the group of entities with annual sales of more than 100 m EUR the number of entities in favor of deferred taxes is larger than in the whole sample (see figures 42 and 43). With regard to external purposes 41% and with regard to internal purposes 34% of the participants of this size cluster state a (very) high benefit of the recognition of deferred taxes. Concerning the evaluation of the costs involved the assessments are more uniform. 54% of the respondents assess them as (very) high (see figure 41). A separate look at the different size clusters reveals that the number of respondents expressing (very) high costs is

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[11] This was e.g. expressed in the responses to the IASB's questionnaire on potential recognition and valuation simplifications for SMEs of April 2005; see www.iasb.org.

[12] See the Communication from the EU Commission of July, 10, 2007 on a simplified business environment for companies in the areas of company law, accounting and auditing, COM (2007) 394 final, p. 8 and 18.

larger in the group of entities with annual sales > 100 m EUR (64%) than in the group with annual sales of 8-32 m EUR (42%) (see figure 44).

Required assessment: **Please assess the required recognition of deferred taxes according to ED-IFRS for SMEs with regard to the following criteria: (n=401)**

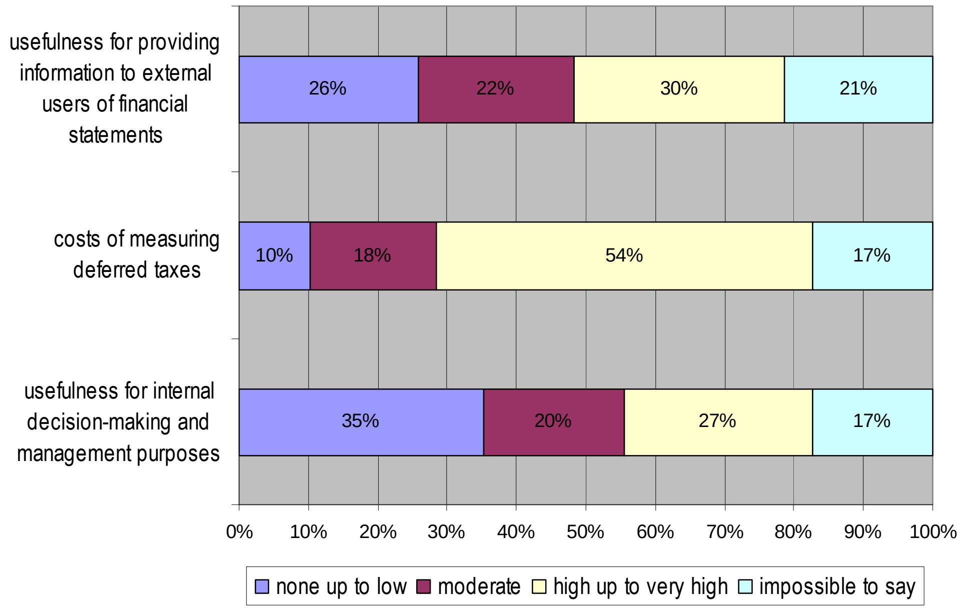

Figure 41: Evaluation of the requirement to recognize deferred taxes

Required assessment: **Please assess the required recognition of deferred taxes according to ED-IFRS for SMEs with regard to the usefulness for providing information to external users of financial statements: (n=397)**

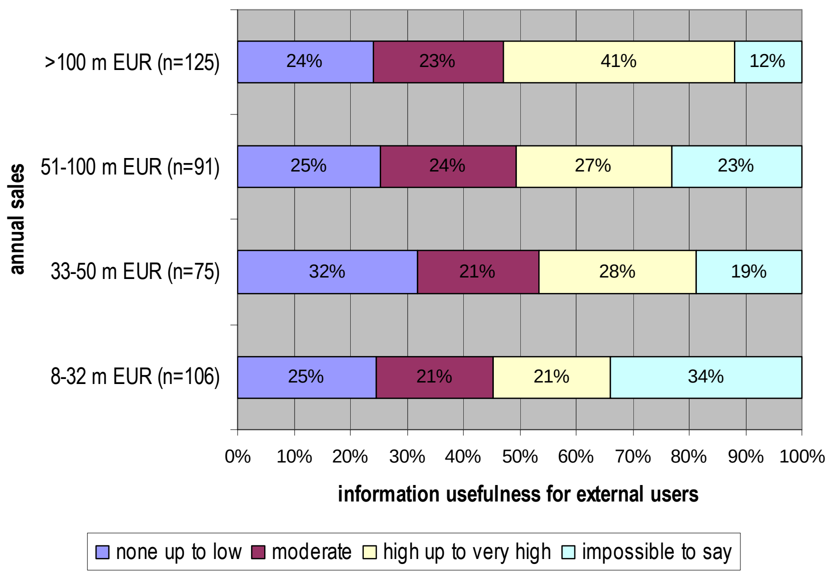

Figure 42: Evaluation of the requirement to recognize deferred taxes with regard to the provision of useful information to external users in relation to annual sales

Required assessment: **Please assess the required recognition of deferred taxes according to ED-IFRS for SMEs with regard to the usefulness for internal decision-making and management purposes: (n=397)**

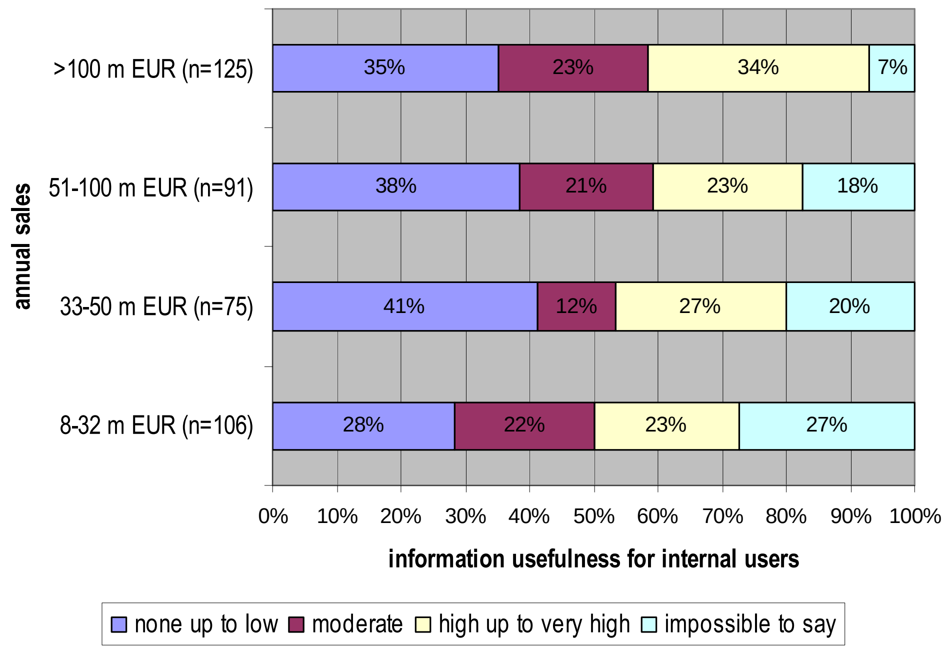

Figure 43: Evaluation of the requirement to recognize deferred taxes with regard to the provision of useful information for internal management and control purposes in relation to annual sales

Required assessment: **Please assess the required recognition of deferred taxes according to ED-IFRS for SMEs with regard to the costs of measuring deferred taxes: (n=397)**

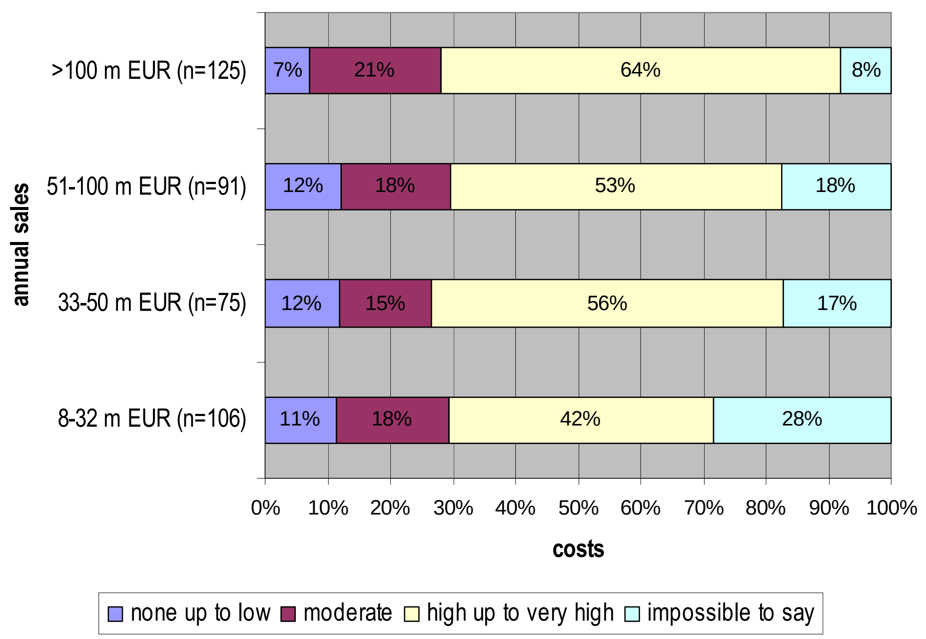

Figure 44: Evaluation of the requirement to recognize deferred taxes with regard to the related costs in relation to annual sales

As already demonstrated above, the knowledge level of the respondents with regard to IFRS has an influence on the structure of the answers given. This is true also for the assessment of deferred taxes (see figure 45). Those with (very) good knowledge (n=83) see higher benefits in the recognition of deferred taxes, but also higher costs. In addition, the proportion of people who mentioned that they were unable to make an evaluation is much lower than in the average of the participants.

Required assessment : for | **Please assess the required recognition of deferred taxes according to ED-IFRS SMEs with regard to the following criteria: (n=82)**

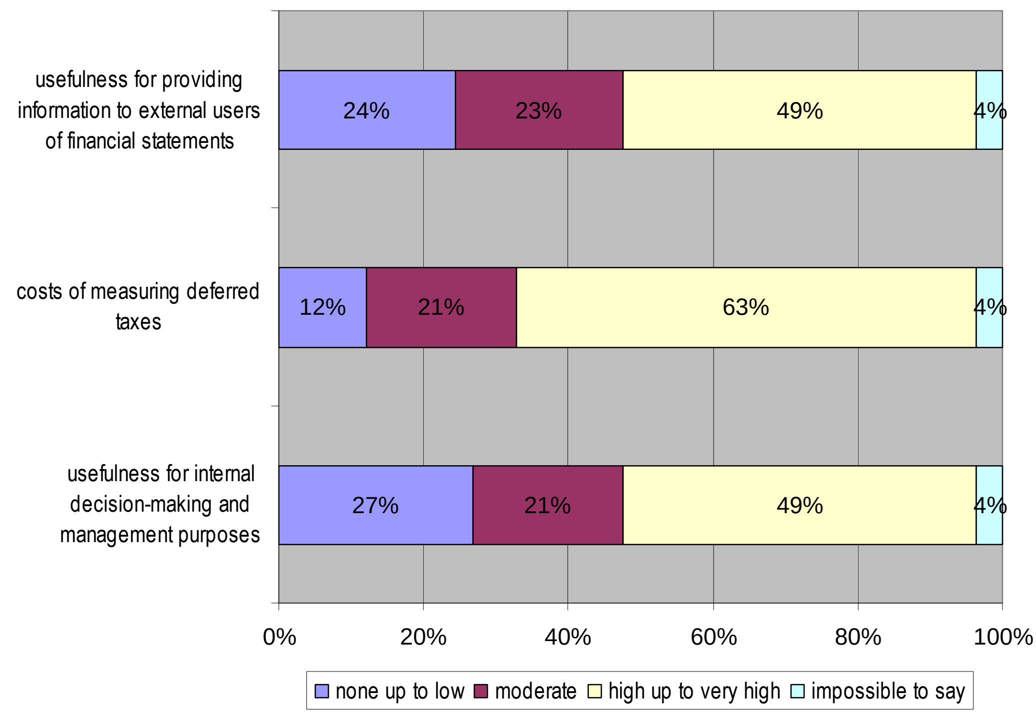

Figure 45: Evaluation of the recognition of deferred taxes by respondents who assess their knowledge of IFRS as (very) good

4.2.3 Accounting for construction contracts

As shown in chapter 4.1.1 the survey reveals that construction contracts have considerable relevance for SMEs. Similar to full IFRS, the IASB requires in Section 22.17 of the ED the recognition of revenues and expenses associated with these contracts, if specific conditions are met, by reference to the stage of completion of the contract activity at the end of the reporting period (using the percentage of completion method, PoC). The entities that answered to the earlier question (see chapter 4.1.1) that they do have construction contracts (n=159) were asked to evaluate this accounting method in comparison to the completed contract method (which is the required method under German GAAP). Figure 46 shows the various answers to this evaluation.

Most of the participants evaluate a higher benefit of the PoC for both, external information purposes (51%) as well as internal purposes (53%). Only a few entities expect a lower benefit than by using the completed contract method: 9% concerning external purposes and 15% concerning internal purposes.

The PoC method requires reliable and on-time project management that provides appropriate data concerning the state of completion, the project cost incurred and planned as well as collectibility of billings etc. In addition the method reveals information about the price calculation of the project. All this is quite often mentioned as factors which provoke costs for the entities. This view is also confirmed by the answers in the survey. 68% of the respondents express higher costs of the PoC compared to the completed contract method, and 57% state that the information required to be provided is more sensitive.

Required assessment : **Please assess the recognition of the contract revenues by reference to the stage of completion of the contract activity at the end of the reporting period (percentage of completion method) compared to revenue recognition only after completion of the entire contract (according to German GAAP):**

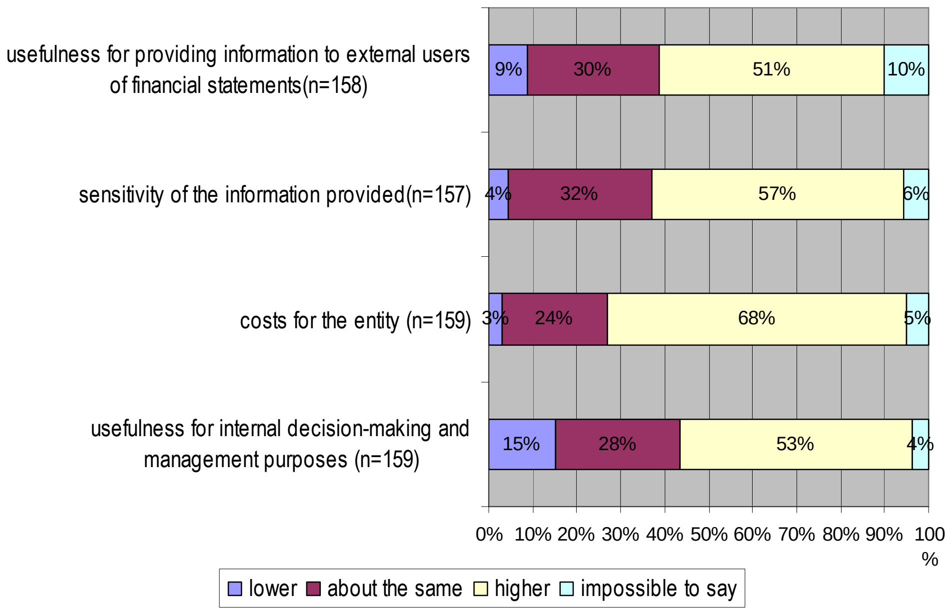

Figure 46: Evaluation of the PoC method in comparison with the completed contract method for construction contracts

A look at the different sizes shows that the answers are more or less comparable over the different clusters; however, the group of companies with 8-32 m EUR of annual sales expects a lower level of benefits for external users (44%) but a higher level of benefits for internal purposes (57%) than the total number of respondents.

4.2.4 *Accounting for employee benefits – defined benefit plans*

According to Section 27 of the ED-IFRS for SMEs the measurement of the defined benefit plan liability is based on actuarial methods and factors such as salary increases, interest rates and actuarial assumptions. If those factors change over the duration of the benefit plan the measurement of the liability must be adapted. The liability should reflect at any reporting date the present value of the obligation of the entity minus the fair value of plan assets at the reporting date out of which the obligations are to be settled directly. The necessary adjustments to the liability at the reporting dates due to changes in the actuarial parameters, the so-called actuarial gains and losses, have to be recognized directly in the income statement.[13]

[13] As explained in ED-IFRS for SMEs BC88 the options of IAS 19 to recognize actuarial gains and losses are not provided to SMEs.

In the survey 265 entities answered that defined benefit plans are relevant for them. Asked about the evaluation of the timely measurement of the defined benefit liabilities as required in the ED, 35% of those entities expressed a (very) high, and 27% a moderate benefit for external recipients of financial statements (see figure 47). A further 27% did not see any benefit for external users. With respect to internal purposes most of the respondents (33%) do not see any or only a little benefit; however, 30% note a moderate and 29% a (very) high benefit. A majority of the answering entities (51%) state (very) high costs of this method to account for defined benefit plans, 29% estimate moderate and 12% little or no cost.

The influence of the actuarial adjustments on the volatility of profit and loss was evaluated similarly. 41% expect a (very) high impact on the volatility of earnings; 27% speak about a moderate and 22% of very little or no impact.

Required assessment : **Please assess the accounting requirements for defined benefit plans according to ED-IFRS for SMEs with regard to the following criteria:**

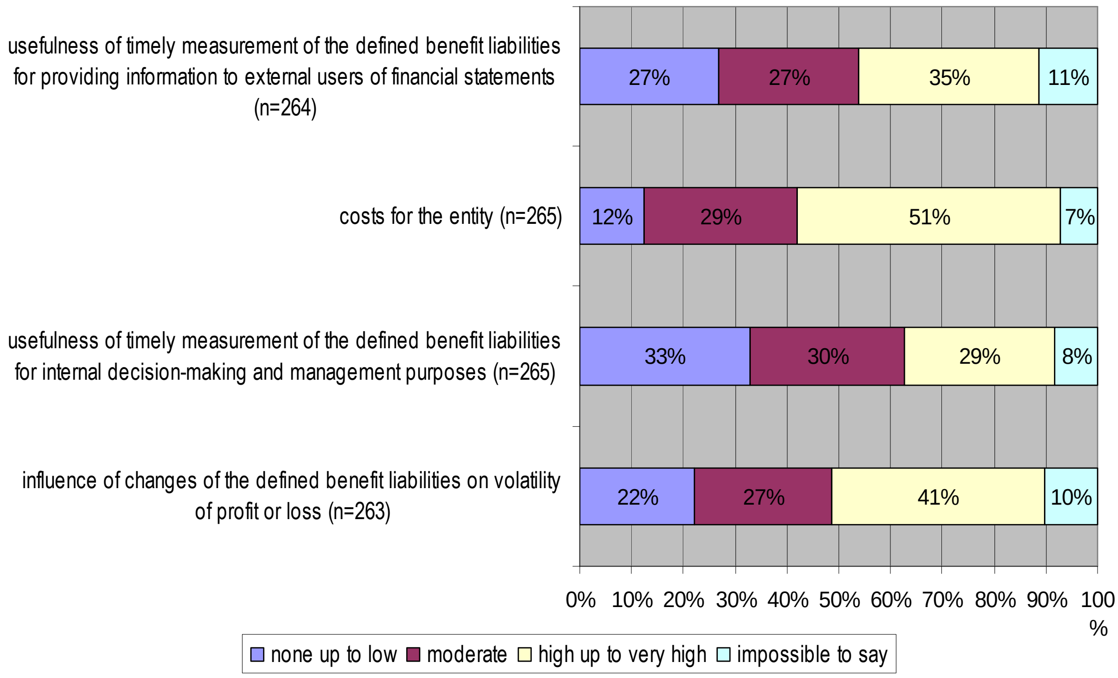

Figure 47: Evaluation of the accounting for employee benefits

Size does not seem to have a material influence on the described evaluations. However, entities of the size cluster “8-32 m EUR of annual sales” estimate a stronger impact on earnings´ volatility but expect higher costs to a relatively lower extent.

Differentiating the answers with respect to the respondents´ personal level of IFRS knowledge it becomes obvious (see figure 48) that those who assess their knowledge of IFRS as (very) good (n=68) evaluate the benefit for external users (43% compared to 35%) and for internal users (41% compared to 29%) tentatively higher than the average of all respondents. Additionally a comparatively higher proportion expects (very) high costs (62% compared to 51%) and a (very) high volatility of earnings (53% compared to 41%).

Required assessment : **Please assess the accounting requirements for defined benefit plans according to ED-IFRS for SMEs with regard to the following criteria: (n=68)**

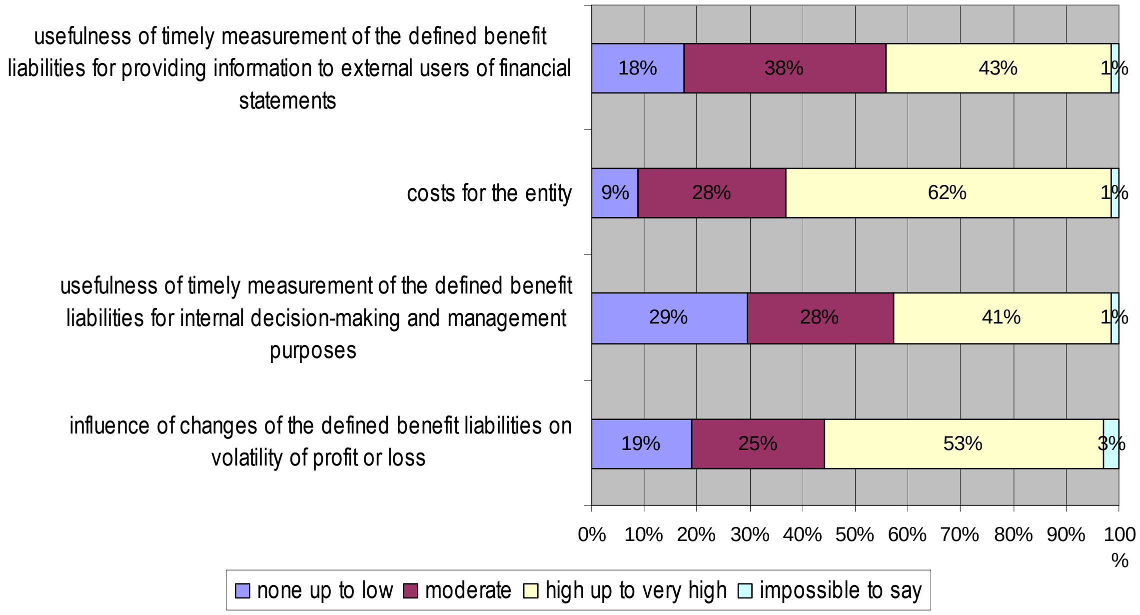

Figure 48: Evaluation of the accounting for employee benefits by respondents who assess their knowledge of IFRS as (very) good

4.3 Evaluation of note disclosures

During the standard-setting process the IASB has postulated reductions and simplifications of disclosures as a main tool for taking the specific cost/benefit relationship of SMEs into account. Although, in comparison with full IFRS, the disclosure requirements in the proposed IFRS for SMEs have substantially been reduced, the number of required disclosures is still considerable. As note disclosures have to be assessed in the context of the related accounting rules, methods and issues, the questionnaire did not include questions on a broad range of different disclosures, in order to keep the questionnaire to an acceptable length. However, the participants were asked to assess the sensitivity of two particular disclosures. The first was about related party transactions (a topic dealt with separately in Section 33 of the ED) and the second about the cost of a business combination (say the cost of a M&A transaction).

With regard to related party disclosures, especially those transactions with owners and key management personnel were assessed as (very) sensitive by the majority of the respondents (see figure 49).

Required assessment : **Please assess the sensitivity of the requested disclosures concerning the following related party transactions:**

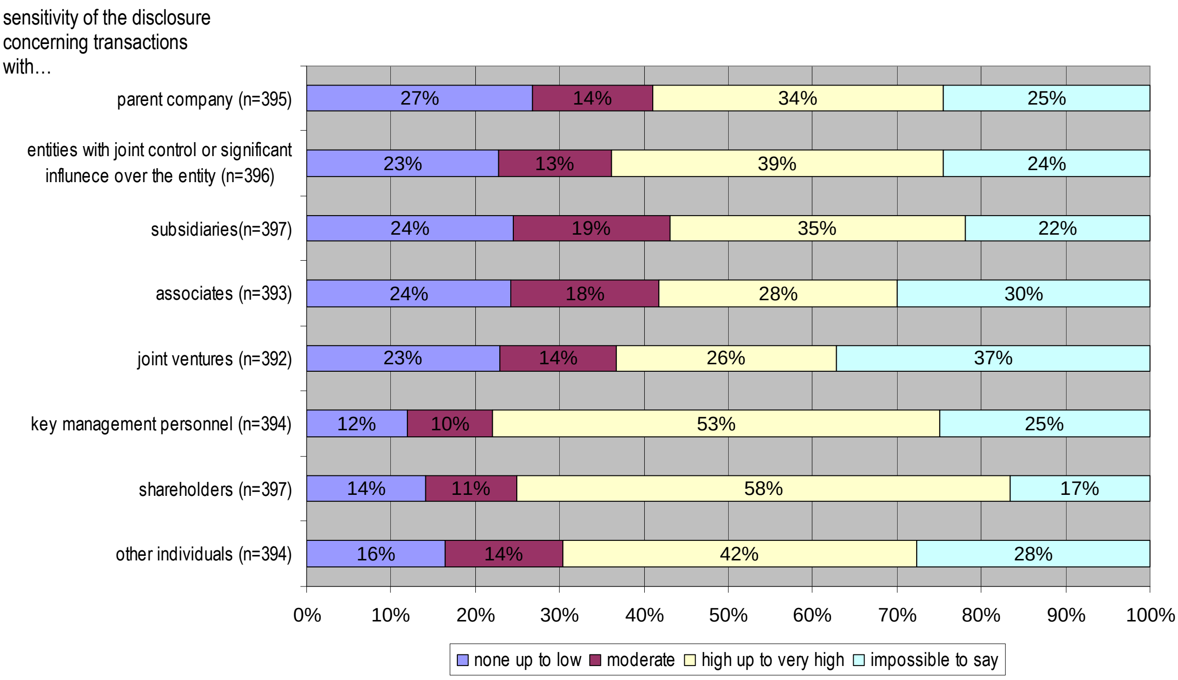

Figure 49: Evaluation of the sensitivity of related party disclosures

The survey reveals a comparable result for the disclosure of the cost of a business combination. The majority of the responding SMEs (n=240) assess this disclosure as very sensitive (52%) and another 20% as sensitive. Only 9% denied a material sensitivity (see figure 50).

Question: **Do you think that the disclosure of the information regarding the purchase price in an acquisition is sensitive information? (n=240)**

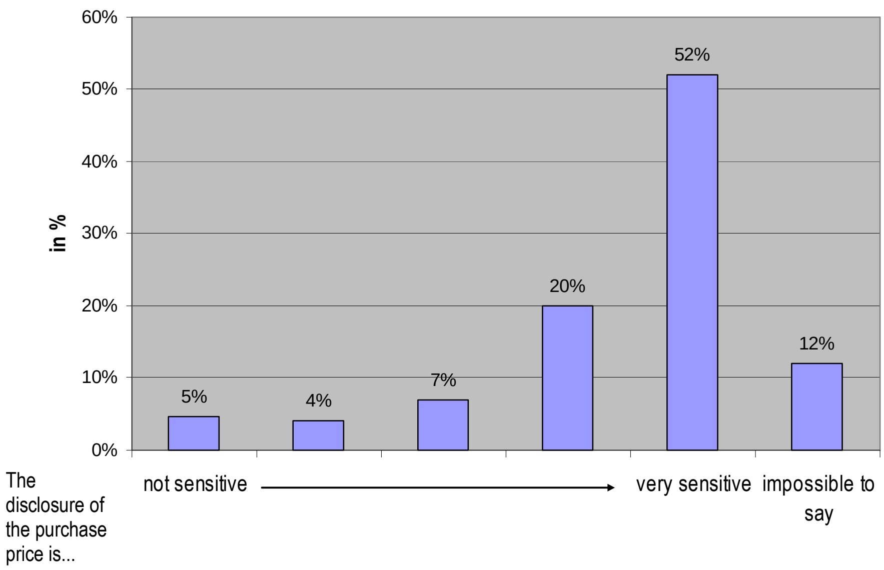

Figure 50: Evaluation of the sensitivity of disclosures on the cost of a business combination

5 HIGHLY RELEVANT QUESTIONS FOR THE REFORM OF GERMAN ACCOUNTING LAW

As the rules of the ED-IFRS for SMEs are based on the full IFRS, which are different to the German legal accounting requirements, it is understandable that the proposal of the IASB also differs from German GAAP to a considerable extent. To improve the international acceptance and comparability of financial statements presented under German GAAP the German legislature has decided to release a revision act to “modernize” German accounting law (so-called “Bilanzmodernisierungsgesetz”) in order to take a step towards convergence with IFRS. The answers given to some of the questions in the survey are therefore of relevance to the German legislature as giving an idea of the opinions of German SMEs with regard to issues that have been seen as candidates for potential change in Germany. As current empirical data about those assessments has been missing so far[14], the results of the survey might also be suitable in helping the German legislature to evaluate the attitudes in corporate practice towards particular accounting methods and issues. However, as already mentioned above, the participants were asked in the questionnaire to respond to the questions without considering the current accounting and taxation framework in Germany, a restriction that has to be kept in mind when analyzing the answers.

Some of the topics already discussed in the previous chapters are part of the accounting law modernization discussion in Germany; these are referred to briefly in the following chapter 5.2. Others are presented afterwards in chapter 5.3.

5.1 Topics already covered

A major topic of potential change is the capitalization of development costs that at present must be expensed under German law. The results of our survey presented above (see chapter 4.1.2) show clearly that with regard to the (external and internal) benefits, the responding SMEs are in favor of a capitalization. However, they also expect higher costs. Therefore, based on a cost/benefit consideration, the survey cannot provide an unequivocal empirical basis for the legislature’s decision.

A similar conclusion must be drawn when looking at the application of the PoC method with respect to construction contracts, an accounting method that has also been controversially discussed during the German reform process. Also in this context the respondents stated higher internal as well as external benefits of the PoC method – compared to the completed contract method – but also higher costs; in addition to this the required disclosures were assessed as sensible with regard to the competitors (see chapter 4.2.3).

Comparably equivocal conclusions can be drawn from the survey with regard to deferred taxes and the accounting for defined contribution plans using the projected unit credit method. As shown in chapter 4.2.2 and 4.2.4 the results of the survey do not determine clearly a particular decision with respect to the cost/benefit consideration.

[14] The only survey on the assessment of potential changes was made in the year 2006 by *Köhler/Marten/Schlereth* (2006).

5.2 Additional questions

5.2.1 <u>Measurement of unfinished and finished products</u>

Contrary to ED IFRS for SMEs 12.7 Article 255 Section 2 HGB (German Commercial Code) allows entities to decide whether to measure finished and unfinished products only at their direct production costs or at their full costs of conversion (direct and indirect costs). Asked about the benefits and costs of this option, the responding SMEs did not provide a clear answer (see figure 51). 32% of them asses the full cost approach as providing higher benefits for external users and 30% do the same for internal purposes. 40% express higher costs of this approach compared to the direct cost approach. The equivocal picture is completed by the high number of respondents that evaluate the benefits and costs of both approaches as being similar (37% for the external and 45% for the internal benefits, 44% for the costs).

Required assessment: **Please assess the obligation to include all costs of conversion according to E-IFRS for SMEs compared to the option under German GAAP to include only directly related costs with regard to the following criteria:**

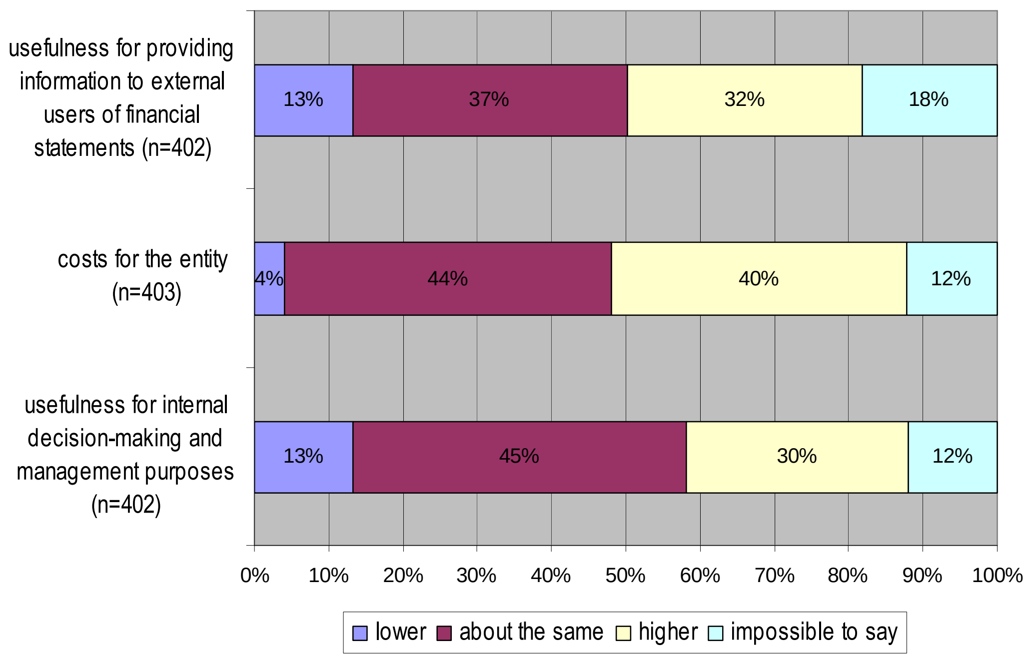

Figure 51: Evaluation of the obligation to measure unfinished and finished products with full or only direct costs of conversion

5.2.2 <u>Cost formulas for inventories</u>

Also equivocal are the replies to the question about the formulas allowed for assigning the cost of inventories. Under German GAAP (Article 256 HGB) entities are also allowed to use – besides the formulas mentioned in ED-IFRS for SMEs 12.17 – the LIFO method and HIFO method ("highest in first out"). Asked about the assessment of the reduction of this wide variety of options to the two methods provided by ED-IFRS for SMEs, the responses did not allow a clear conclusion (see figure 52). More than 50% do not express a preference for the wide range of options.

Required Assessment:	**Please assess the restriction of cost formulas for inventories according to ED-IFRS for SMEs compared to the cost formulas available under German GAAP with regard to the following criteria: (n=399)**

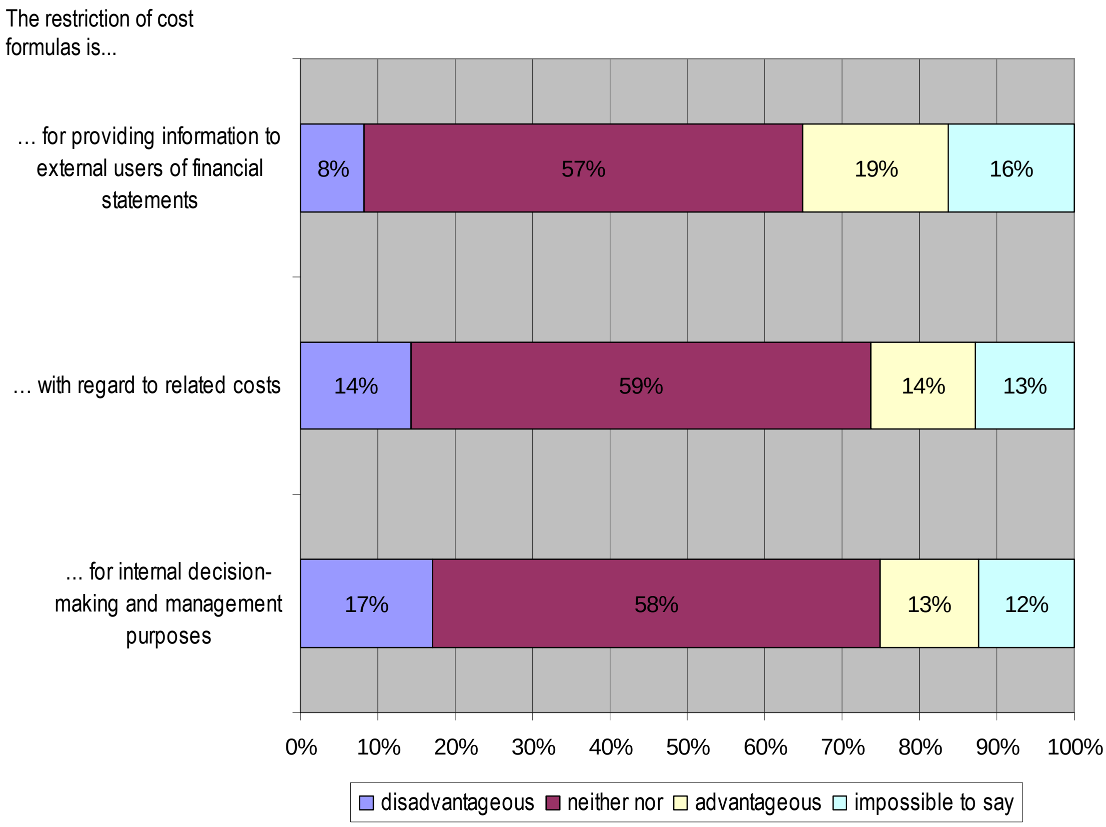

Figure 52: Evaluation of the restricted number of allowed cost formulas for the measurement of inventories

5.2.3 Accounting for provisions

Discounting of long-term provisions

With the exception of employee benefit plan provisions, German GAAP do not require or allow the discounting of provisions. The participants were therefore asked in the survey to assess the discounting of provisions required under ED-IFRS for SMEs. The answers depict a tendency towards a reserved evaluation (see figure 53). Only 25% of the entities expect a higher benefit from discounting for external users compared to non-discounting and 18% do so for internal management purposes. More people assess both approaches as equally useful (41% regarding internal and 45% external uses). However, the majority (53%) expect that discounting incurs higher cost.

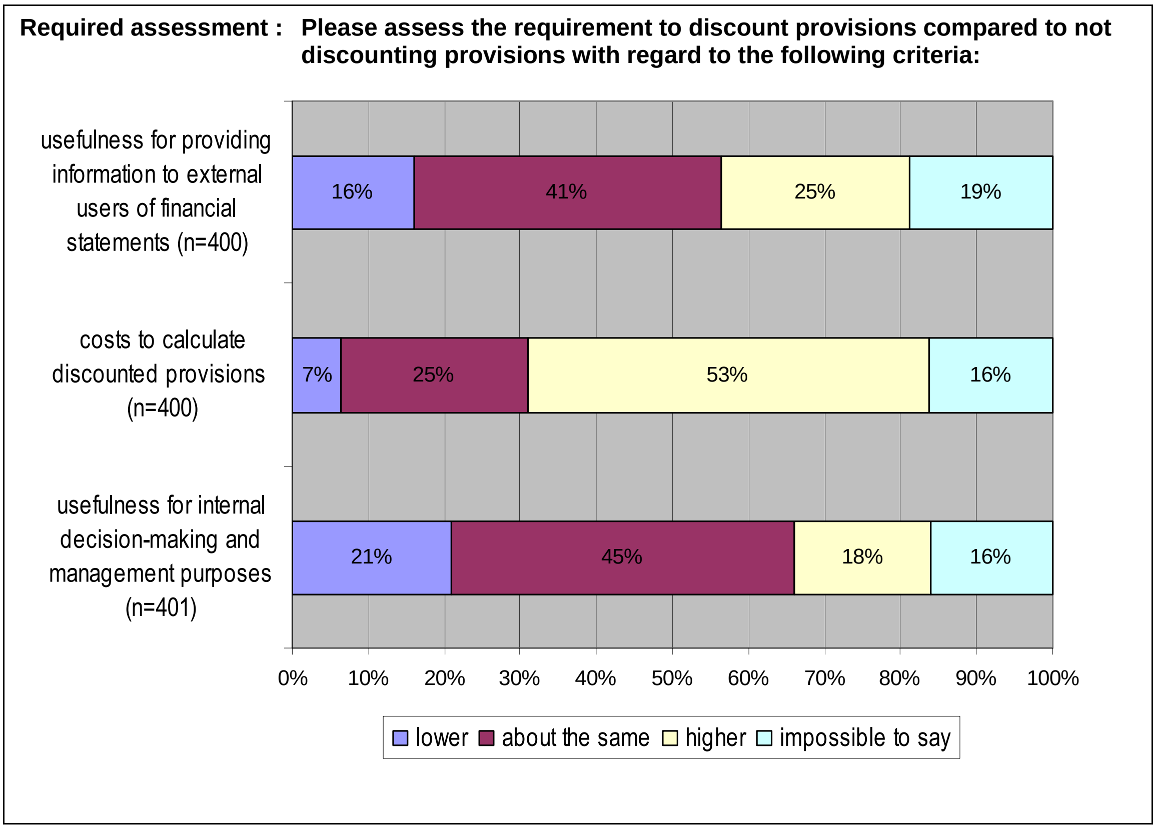

Figure 53: Evaluation of the discounting of provisions

Recognition of provisions for particular expenses

Contrary to IFRS, under particular circumstances entities may recognize provisions for liabilities without a legal or constructive obligation (so-called "Aufwandsrückstellungen") under German law (Article 249 Sections 1 and 2 HGB). Asked about the implicit prohibition of such a provision under ED-IFRS for SMEs, the respondents expressed themselves relatively in favor of the option under German GAAP (see figure 54). Only 20% assess the prohibition as more useful for external decision purposes than the option.

Required assessment: **Please assess the prohibition against recognizing provisions for liabilities without a legal or constructive obligation according to ED-IFRS for SMEs compared to the option to recognize these provisions under German GAAP with regard to the following criteria:**

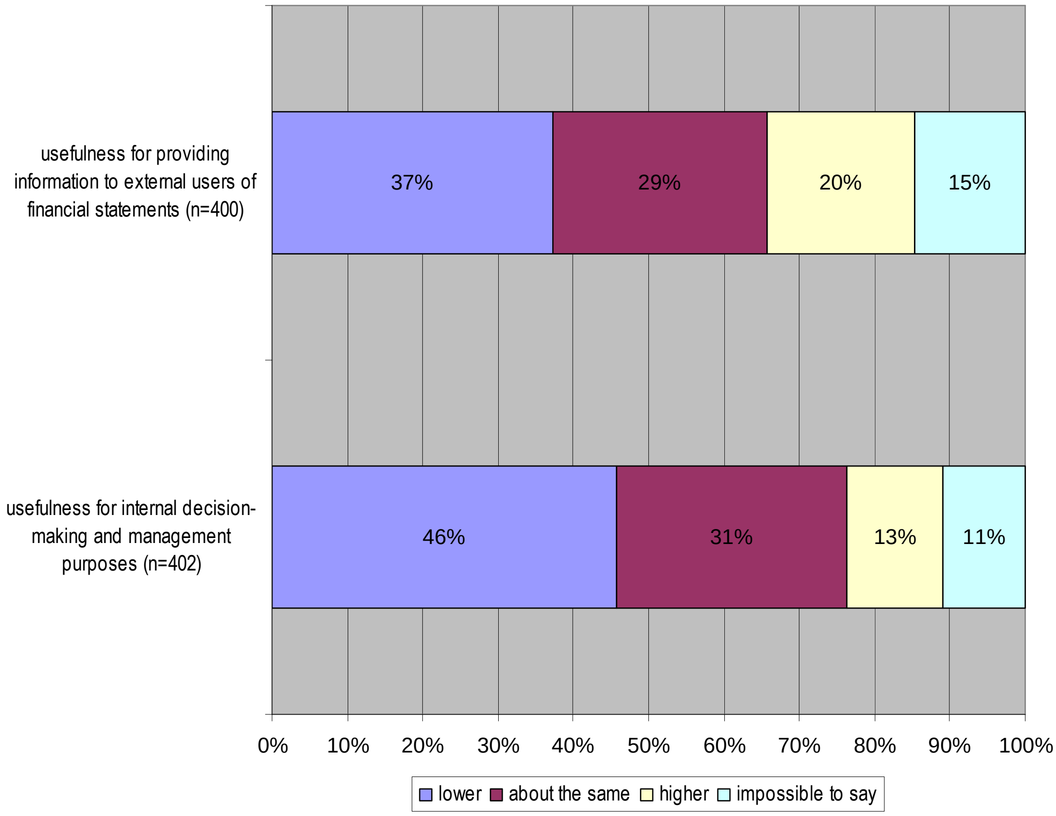

Figure 54: Evaluation of the implicit prohibition against recognizing provisions for liabilities without a legal or constructive obligation

5.2.4 Capitalization of business start-up and expansion expenses

To date, German accounting law also provides an option either to capitalize business start-up and expansion expenses or to recognize them directly in the income statement (Article 269 HGB). Asked about this option the participants gave a similar answer as to that above, concerning the provisions for particular expenses. From a relative perspective, the option is evaluated more positively by the entities than the prohibition. Only 16% assess the requirement of the IFRS to expense those costs as more beneficial for external users than the capitalization option provided under German GAAP (see figure 55).

Required assessment:	**Please assess the prohibition against recognizing start-up and business expansion expenses as assets according to ED-IFRS for SMEs compared to the option to recognize them under German GAAP with regard to the following criteria:**

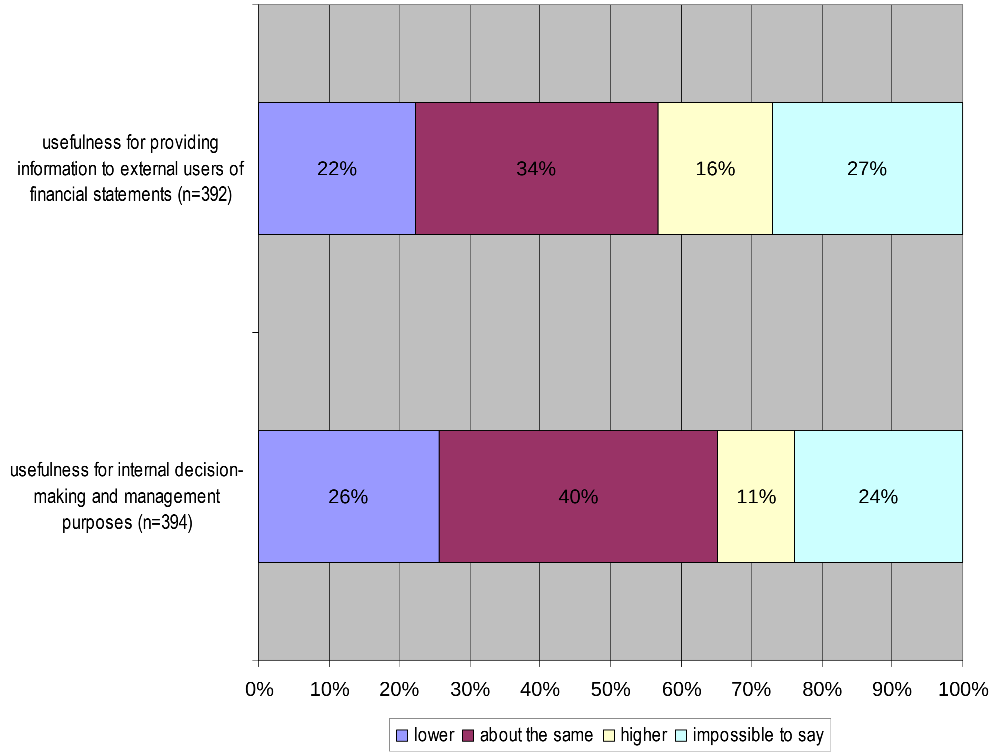

Figure 55: Evaluation of the implicit prohibition against capitalizing business start-up and expansion expenses

6 SUMMARY

The survey reveals that German SMEs conceive owners, banks, entities´ management and the tax authority as the main users of their financial statements (see chapter 3.1). Customers, vendors, employees and potential investors are of minor relevance, even though the IASB views them as main groups of external users. Moreover, the IASB, focusing on general purpose financial statements for external users, does not consider particular information needs of (owner-) managers and tax authorities in their cost-benefit considerations, because both parties are in a position to demand reports tailored to meet their particular information needs and therefore do not have to base their decisions on general purpose financial statements. However, the survey shows information to (owner-) managers and the calculation of taxable income as major objectives of financial statements in German SMEs.

In addition, the survey shows (see chapter 3.2) that a considerable number of SMEs (in all size clusters investigated) have material cross-border business activities in terms of export and import of goods and services as well as investments in foreign subsidiaries, whereas financing through equity or foreign borrowings happens quite rarely.

This has an influence on the attitude of the entities concerning their need to provide internationally comparable financial information (see chapter 3.3). Approximately a third of the participants of the survey stated that they see at least a moderate need, though only a few of them really express a very high need.

In order to assess the adequacy of the number and variety of accounting issues regulated in the ED-IFRS for SMEs it is necessary to find out which types of issues occur regularly in SMEs and which ones happen only seldom. As explained in chapter 4.1.1 and summarized in table 1 the survey reveals that especially construction contracts, employee benefit plans, research and development projects, as well as investments (with an interest of more than 50%) in non-publicly traded entities, are issues SMEs encounter regularly in Germany (although with size-specific differences).

Without material size differences some issues mentioned in the ED-IFRS for SMEs seem to occur (very) rarely in SMEs, according to the survey's results. These are: finance leases with the SME as a lessor, share-based payments, investment properties and discontinuing operations. Hedge instruments, which are more common in large than in small SMEs, are primarily used to hedge foreign currency risks. The survey also shows that business combinations occur more or less regularly within SMEs and that therefore topics such as consolidations and accounting for goodwill are highly relevant for those entities (see figure 23).

Frequency of occurrence and relevance of transactions	**often up to very often/ very high up to high relevance**	**sometimes/ moderate relevance**	**not at all up to seldom/ no up to low relevance**
Construction contracts (n=312)	38%	6%	56%
Defined benefit plans (n=404)	31%	19%	42%
Research and development projects in the company (n=407)	29%	15%	56%
Investments in non-listed limited companies or partnerships with an investment of more than 50% (n=410)	29%	3%	50%
Transactions in order to hedge the foreign exchange risks in foreign currency positions (n=406)	21%	13%	66%
Defined contribution plans (n=399)	18%	25%	50%
Transactions in order to hedge the foreign exchange risks in a firm commitment or a highly probable forecast transaction (n=403)	11%	12%	78%
Transactions in order to hedge the interest rate risk (n=402)	9%	21%	70%
Transactions in order to hedge price risks (n=402)	8%	13%	80%
Cash-settled share-based payment transactions (n=410)	8%	11%	77%
Investments in non-listed limited companies or partnerships with an interest of 20%-50% (n=410)	7%	8%	62%
Investments in listed limited companies with an interest of 20%-50% (n=410)	7%	1%	75%
Investments in listed limited companies with an interest of more than 50% (n=410)	7%	1%	75%
Joint ventures	6%	9%	71%
Transactions in order to hedge foreign exchange risks in a net investment in a foreign operation (n=400)	6%	7%	87%
Share-based payment transactions with cash alternatives (n=410)	4%	7%	85%
Leases with the entity being the lessor (n=407)	3%	4%	93%

Investment property (n=410)	3%	10%	74%
Equity-settled share-based payment transactions (n=410)	1%	4%	91%
Sale of businesses or discontinuation/sale of business operations (n=406)	1%	13%	85%

Table 1: Relevance or frequency of occurrence of particular accounting issues

The findings of the survey depict a quite equivocal picture. While the issues investigated seem to occur regularly and be highly relevant for some of the SMEs, they seem to occur never or rarely for some others. Therefore, making the decision as to which of the issues should be regulated explicitly and which should not be dealt with in the ED-IFRS for SMEs, it is necessary to balance carefully the advantages and disadvantages that can be expected. The elimination of the regulation of specific issues from the ED may help to reduce the volume and the complexity of the standard, which would be beneficial for those SMEs that do not encounter these issues. However, in doing so the complexity and the costs of application could rise for those SMEs which are confronted with such issues, because they have either to follow the reference to the full IFRS (if required) or to derive a solution by applying the rules in ED IFRS for SMEs 10.3, which demand the finding of guidance from other rules of the SME standard or the application of the pervasive principles of Section 2 of the ED. Both alternatives can provoke considerable costs, which might justify the inclusion of an explicit simplified regulation in the SME standard.

The findings with regard to the specific accounting issues investigated reflect the divergent positions that can be heard in the public discussion on IFRS in general and the ED-IFRS for SMEs in particular (see chapter 4.1.2 and 4.2). There is no question which is unequivocally answered in a positive or negative way by the respondents. Many questions have a proportion of between 20% and 40% of answers which evaluate specific accounting methods (issues) equally; this means they do not state a higher or lower benefit or cost of the given alternatives.

These results may not be explained by the fact that the respondents did not know what they were answering, or that they had no knowledge of IFRS, because all the answer sections of the questionnaire had an option “unable to evaluate” where appropriate, and this option was chosen quite often by the participants; with smaller companies using it more often than the respondents on average (on average this option was chosen in 10%-20% of the cases, whereas for some questions the proportion of smaller companies was up to 40%). It also can be seen that with increasing knowledge of IFRS[15] this answer option was chosen more rarely. It may therefore be supposed that the respondents who gave a specific answer in favor or against a particular accounting method had sufficient knowledge and understanding of the matter concerned, and that the answers may therefore be assessed as reliable.

Concerning the usefulness of specific accounting rules for external information needs, the respondents assessed the following rules in the majority as positive: revaluation of property, plant and equipment if a market value is available, the specific treatment of assets held for sale under ED-IFRS for SMEs, the percentage of completion method to account for construction contracts, and the capitalization of development costs (see table 2). However, at the same time, the participants also associated higher costs with the application of these rules (see table 3). Although it is not possible to counterbalance costs and benefits, because they are not quantitatively measurable, the results are able to indicate potentials for further simplifications in the ED-IFRS for SMEs. Modifications of the ED appear to be more obvious for proposed accounting treatments, where the majority of the SMEs do not state large(r) benefits, but expect

[15] 53% of the respondents stated that they assess their knowledge of IFRS as moderate or even better.

high(er) costs. This is for example the case with the revaluation of intangible assets, the obligation to recognize deferred taxes, the timely measurement of pension provisions, the obligation to discount provisions, the revaluation of property, plant and equipment, where market prices do not exist and the fair value has to be estimated (see tables 2 and 3).

Assessment of the usefulness of the accounting methods mentioned ***for providing information to external users of financial statements***	**(very) high/ higher**	**about the same/ neither nor**	**low or none/ lower**
Revaluation model compared to the cost model for property, plant and equipment if a market price exists (n=396)	52%	22%	12%
Specific treatment for "non-current assets held for sale" compared to accounting under the German Commercial Code (n=399)	52%	16%	15%
Application of the percentage of completion method compared to the revenue recognition only after completion of the entire contract (n=158)	51%	30%	9%
Capitalization of development costs compared to the recognition of development costs as expense (n=399)	41%	20%	13%
Revaluation model compared to the cost model for intangible assets(n=400)	36%	25%	16%
Required recognition of deferred taxes according to ED-IFRS for SMEs (n=401)	30%	22%	26%
Timely measurement of defined benefit liabilities according to ED-IFRS for SMEs (n=264)	35%	27%	27%
Obligation to include all costs of conversion according to ED-IFRS for SMEs compared to the option under German GAAP to include only directly related costs (n=402)	32%	37%	13%
Requirement to discount provisions compared to not discounting them (n=400)	25%	41%	16%
Revaluation model compared to cost model for property, plant and equipment if fair value needs to be estimated (n=395)	23%	29%	33%
Prohibition to recognize provisions for liabilities without a legal or constructive obligation according to ED-IFRS for SMEs compared to the option to recognize these provisions under German GAAP (n=400)	20%	29%	37%
Component approach compared to a uniform depreciation for all components (n=403)	19%	38%	28%
Restricted cost formulas for inventories under ED-IFRS for SMEs compared to the cost formulas available under German GAAP (n=399)	19%	57%	8%
Prohibition to recognize start-up and business expansion expenses as assets according to ED-IFRS for SMEs compared to the option to recognize them under German GAAP (n=392)	16%	34%	22%

Table 2: Evaluation of the usefulness of particular accounting treatments of the ED-IFRS for SMEs for the provision of information to external users of financial statements

Assessment of the ***costs*** *connected with the application of the accounting method mentioned*	**(very) high/ higher**	**about the same/ neither nor**	**Low or none/ lower**
Revaluation model compared to the cost model for property, plant and equipment if a market price exists (n=399)	48%	32%	10%
Specific treatment for "non-current assets held for sale" compared to accounting under the German Commercial Code (n=400)	56%	26%	6%
Application of the percentage of completion method compared to the revenue recognition only after completion of the entire contract (n=159)	68%	24%	3%
Capitalization of development costs compared to the recognition of development costs as expense (n=402)	58%	17%%	3%
Revaluation model compared to the cost model for intangible assets (n=400)	64%	17%	3%
Required recognition of deferred taxes according to ED-IFRS for SMEs (n=401)	54%	18%	10%
Timely measurement of defined benefit liabilities according to ED-IFRS for SMEs (n=265)	51%	29%	12%
Obligation to include all costs of conversion according to ED-IFRS for SMEs compared to the option under German GAAP to include only directly related costs (n=403)	40%	44%	4%
Requirement to discount provisions compared to not discounting them (n=400)	53%	25%	7%
Revaluation model compared to cost model for property, plant and equipment if fair value needs to be estimated (n=399)	58%	22%	9%
Prohibition to recognize provisions for liabilities without a legal or constructive obligation according to ED-IFRS for SMEs compared to the option to recognize these provisions under German GAAP (n=400)	was not investigated		
Component approach compared to a uniform depreciation for all components (n=404)	74%	11%	6%
Restricted cost formulas for inventories compared to the cost formulas available under German GAAP (n=399)	14%	59%	14%
Prohibition to recognize start-up and business expansion expenses as assets according to ED-IFRS for SMEs compared to the option to recognize them under German GAAP (n=392)	was not investigated		

Table 3: Evaluation of the costs related with particular accounting treatments of the ED-IFRS for SMEs

The attitude of German SMEs with regard to accounting options seems to be completely equivocal. The majority of SMEs assess the option to revalue property, plant and equipment and intangible assets, as well as the option to capitalize development costs, as neither advantageous nor disadvantageous (see table 4). However it is also obvious that the number of respondents that assess advantages is larger than the number that assess disadvantages. This might be interpreted as a tendency to hold that the options are as a whole more likely to be beneficial than not beneficial. From the above cost-benefit consideration (see tables 2 and 3) it may be concluded that the revaluation option in particular is evaluated as unattractive if a precise market value does not exist.

Assessment of options	**advantageous**	**Neither nor**	**disadvantageous**
Option to account for property, plant and equipment using either the cost model or the revaluation model (n=406)	28%	40%	25%
Option to account for intangible assets using either the cost model or the revaluation model (n=402)	25%	46%	14%
Option to capitalize development costs or to recognize them as an expense (n=405)	29%	42%	10%

Table 4: Evaluation of accounting options

With respect to disclosures required by the ED-IFRS for SMEs the statements of the respondents are also equivocal (see chapter 4.3). However, it seems that respondents assess information about transactions with related persons, such as key managers or owners, and information on the cost of a business combination as being quite sensitive. Furthermore the separate disclosure of assets held for sale, as well as the information required to be given when the percentage of completion method is applied, are evaluated as being more sensitive than the respective treatment under German GAAP. The findings tentatively suggest, at least from the preparers´ perspective, that the IASB should reconsider the disclosure requirements in terms of whether they sufficiently meet the particular situations of SMEs and their users.

The heterogeneous picture of the answers to the individual questions is also reflected in the statements the respondents made in answer to the final summarizing question of the questionnaire. The participants were asked whether they assess – based on the limited insight into the content of the ED-IFRS for SMEs provided by the questionnaire – the ED-IFRS for SMEs as “attractive” enough that they would consider applying the standard in their single and/or consolidated accounts if it were legally possible in future. 16% of the responding entities (n=398) answered with “yes”. 83% of those that answered with “no” stated that they prefer German GAAP, 10% noted a preference for full IFRS and the rest gave different (e.g. US GAAP) or no responses. This shows the reluctance of German SMEs with regard to the IFRS for SMEs and corresponds more or less to the proportion of companies expressing the need for internationally comparable financial information.

In interpreting the results of the survey the following restrictions must be considered: they reflect only the assessments of entities that meet the chosen SME definition, that are based in Germany, and that were willing to participate in the survey. The survey’s results may therefore not be generalized to evaluate the appropriateness of the ED-IFRS for SMEs to serve adequately on a worldwide basis for non-publicly traded entities, without regard to their legal and socio-economic environment. However, the findings may be regarded as a valuable and current resource of the attitudes and assessments of a large number of SMEs, and one which is able to provide fruitful empirical input into the national and international discussion about the SMEs´ expectations and evaluations with regard to financial statements, their objectives and accounting methods applied.

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