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Berlin, 24. April 2009

European Commission
Internal Market and Services DG
Unit F3 – Financial Reporting Policy
Mr Jeroen Hooijer
Head of Unit
SPA2 00/89
BE – 1049 Brussels

Dear Jeroen,

Consultation Paper on Review of the Accounting Directives

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the Consultation Paper on Review of the Accounting Directives. We appreciate the opportunity to comment on the Consultation Paper.

We support the European Commission in its objective to simplify and modernise the requirements for SMEs and other companies within the scope of the Fourth and Seventh Company Law Directives as these Directives form the common accounting basis for listed and non-listed companies and as during the last three decades of their existence the business environment, accounting practices and user needs have changed significantly. Because of this, we regret the challenging timeframe of the project which does not give sufficient time for the necessary discussions.

Please find our detailed comments on the questions raised in the Consultation Paper in the appendix to this letter.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

We are:

Preparer:	☐ company	☐ subsidiary of foreign company	☐ organisation of companies
If company, please specify your sector	☐ services	☐ production	☐ agriculture
User:	☐ bank/credit provider	☐ analyst	☐ organisation of stakeholders
	☐ private person		
Public authority:	☐		
Accountants and auditors:	☐ accounting	☐ audit	☐ organisation of accountants and auditors
Other:	☒ (please specify)	Standardsetting body	

Name of your organization/company: Accounting Standards Committee of Germany (ASCG)

Short description of the general activity of your organization/company: The Accounting Standards Committee of Germany is registered as a non-profit organisation domiciled in Berlin. Its statutory duties under Section 342(1) of the German commercial law are:

- to develop recommendations (standards) for the application of accounting principles for consolidated financial reporting,
- to advise the Federal Ministry of Justice on planned legislation on accounting regulations
- to represent the Federal Republic of Germany on international standard-setting bodies

Country where your organization/company is located: Germany

Contact details incl. e-mail address: see above

APPENDIX

Question 1

Do you agree with the approach described above? ☒ YES ☐ NO ☐ Don't know. Please comment: …

We agree with the approach of concentrating the main principles in one dedicated section to emphasize the importance of these principles, which have worked well for many years.

We share your assessment that a conceptual accounting debate would be very time-consuming because of the different developments which can be observed in some Member States (i.e. some Member States apply or would like to apply IFRS or IFRS-based rules to annual accounts also for non-listed companies; other Member States, such as Germany, favour their own accounting requirements which in their view better fit the needs of SMEs). We are aware that such a discussion could exceed the given timeframe of the project. Nevertheless, we are of the opinion that sooner or later these issues have to be discussed to further develop the Accounting Directives into a comprehensive framework, and to reach a common understanding among Member States of the principles mentioned in the Consultation Paper.

Question 2

Are there any other principles that should be included in the "General principles" section? Should any of the current principles be clarified? Please comment: …

Regarding IFRS and US GAAP, different conclusions have already been drawn from the financial crisis. But what in our opinion can really be learned by the financial crisis is the fact that the reliability of the information given in accounts is a key factor for users. We therefore suggest including this principle in the Fourth and Seventh Directives.

Furthermore, we see a need for clarification of the current principles because the principles are applied quite differently among Member States. For example, regarding the realisation principle in accordance with Article 31 (1) c of the Fourth Directive, some Member States allow the percentage of completion method, other Member States, such as Germany, prefer a stricter understanding of realisation and do not allow this method.

Question 3

Do you believe that a restructured Directive following a bottom-up approach would be useful to Member States in creating more simplified and straight-forward rules? ☐ YES ☒ NO ☐ Don't know. Please comment: …

The proposal to change the structure of the Fourth Directive from a top-down to a bottom-up approach is an interesting idea because the focus of the Directive would switch from large companies to small companies. However, we do not believe that such a restructuring would help Member States to streamline the requirements of their local GAAP because a simplification of the requirements can only be reached by material changes of the Directive.

Question 4

Do you think that current rules for small, medium and large companies are appropriate? ☒ YES ☐ NO ☐ Don't know. Please comment: …

Please indicate in broad lines what the minimum requirements for small entities should be according to the bottom-up approach.

We have no explicit empirical data which deal with the current requirements of the Fourth and Seventh Directives. However, in September 2008 the ASCG together with the University of Regensburg finalised an empirical study on the role and usefulness of general purpose financial statements of Small and Medium Sized Entities from the perspective of banks as these represent the main users of such financial statements. The study can be downloaded from the ASCG's website (www. standardsetter.de/drsc/docs/ press_releases/080917_ASCG _Surveyontheexpectationsofbanks.pdf). The following excerpt of our study (see pages 26 and 27) shows with regard to the assessment of creditworthiness which accounting requirements proposed in the ED-IFRS for SMEs are considered by banks to be of advantage, disadvantage or neither of both (i.e. indifferent):

Assessment of the advantageousness of accounting methods in view of information benefits in credit decisions	***advantageous***	***indifferent***	***disadvantageous***
Component approach compared to a uniform depreciation charge	54%	27%	15%
Revaluation model for property, plant and equipment compared to the cost model – with existing market prices	66%	15%	15%
Revaluation model for property, plant and equipment compared to the cost model – with estimated revalued amounts	30%	10%	56%
Separate presentation of non-current assets held for sale	73%	10%	13%
Measurement of investments in associates at equity compared to the cost model	61%	17%	15%
Measurement of investments in associates at fair value compared to the cost model – with existing market prices	58%	7%	29%
Measurement of investments in associates at fair value compared to the cost model – with estimated revalued amounts	24%	12%	58%
Measurement of financial instruments at fair value compared to the cost model – with existing market prices	71%	3%	19%
Measurement of financial instruments at fair value compared to the cost model – with estimated revalued amounts	27%	10%	56%
Measurement of financial instruments at fair value compared to the cost model – with estimated revalued amounts	66%	5%	19%

Assessment of the advantageousness of accounting methods in view of information benefits in credit decisions	***advantageous***	***indifferent***	***disadvantageous***
Measurement of financial instruments at fair value compared to the cost model – with estimated revalued amounts	27%	12%	49%
Capitalisation of development costs compared to the recognition as expense	17%	25%	49%
Revaluation model for intangible assets compared to the cost model	39%	24%	32%
Impaired only goodwill compared to the periodic amortisation	17%	53%	25%
Obligatory capitalisation of deferred tax assets compared to the non-recognition	36%	37%	10%
Not presenting extraordinary items in the income statement separately compared to a separate presentation	5%	8%	82%
Separated presentation of revaluation differences in the income statement compared to a non-separate presentation	78%	15%	3%

Table 1: Assessment of the advantageousness of accounting methods in view of information benefits for credit decisions

With regard to the assessment of the usefulness of specific financial reporting issues of the ED-IFRS for SMEs the major findings are (see also Table 1):

Primarily positive assessments were made with regard to

- the components approach of the depreciation of property, plant and equipment,
- the revaluation of property, plant and equipment if a market price exists,
- the separate disclosure of non-current assets held for sale,
- the measurement of investments in associates at equity or at fair value (the latter only if a market price exists) and
- the measurement of financial instruments at fair value if a market price exists

The subsequent measurement of goodwill according to the impairment-only-approach and the recognition of deferred tax assets were assessed mainly as indifferent, because the recoverability of these items is not perceived as being reliable. Thus, it is a common practice of banks to set off intangible assets and deferred tax assets against equity. Also the assessment of the revaluation option of intangible assets was quite unequivocal, as the bankers often do not rely on the amounts presented, as there usually is no market value.

What the bankers criticised the most was the “mark to model” approach when determining fair values. The results of this approach depend considerably on the model assumptions and it is seen as too burdensome to get a proper understanding of the valuation process. An almost uniform negative assessment was made with regard to the recognition of development costs.

Additionally the interviewees were not in favour of accounting options such as the measurement choice between the cost and revaluation model for property, plant, equipment, and the choice between the equity and fair value method for investments in associates.

Another critical issue was the presentation format of the balance sheet and the income statement. Banks need an explicit format with a detailed structure and specifications of the items in order to find the necessary information quickly and to compare it between the entities. In addition, they evaluated the disallowed disclosure of extraordinary items on the face of the income statement as a real problem, because it hinders their objective to determine the ordinary and sustainable income of the period.

Question 5

Please provide reasons why Member States did not make full use of the options available in the current Accounting Directives. Please comment: …

Germany makes full use of all options available in the current Accounting Directives to simplify the accounting requirements. Nevertheless, we have doubts about forcing all Member States to use the options in the same manner because the economic and legal environments are different in Member States. Accordingly, there can be good reasons to exercise the options differently.

Question 6

What can be done to further simplify the Directives in respect of Member State options?

No comment.

Question 7

Do you think the current criteria (balance sheet total, net turnover, average number of employees) have worked well? ☒ YES ☐ NO ☐ Don't know. If no, please indicate what other criteria should be considered.

No further comment.

Question 8

Do you believe that the current thresholds for small, medium and large companies are appropriate? ☒ YES ☐ NO ☐ Don't know. Please comment: …

No further comment.

Question 9 In your opinion, would it be appropriate to reduce the number of company categories in the Directives? ☐ YES ☒ NO ☐ Don't know. If yes, would you prefer: ☐ Option 1 ☐ Option 2

In our opinion the current categories have worked well for many years. They allow Member States to fit the accounting requirements to the size of the companies. From our perspective especially option 1 seems to be problematic because that would exempt medium-sized companies from the auditing requirement. We believe that these companies have reached a size which makes audits useful to increase the reliability of the given information.

Question 10 Do you see any other approaches to reduce the number of company categories? ☐ YES ☒ NO ☐ Don't know. Please comment: …

No further comment.

Question 11 Regarding the table above, do you see additional room for simplification, e.g. eliminating the requirement for annual reports for medium-sized enterprises? ☐ YES ☒ NO ☐ Don't know. Please comment: …

In our view the information given in annual reports are quite useful for users of financial statements of medium-sized companies. These companies have reached a size which justifies the additional costs in relation to the benefits for users.

Question 12 Do you believe that cash-based information should be explicitly required in the Directives? ☐ YES ☒ NO ☐ Don't know. If yes, for which company categories?

We are aware of the fact that cash-based information would also be useful for users of financial statements of non-listed companies. Nevertheless, we believe that especially for small companies the cost-benefit analysis does not justify additional requirements.

Question 13 Should the requirement be for a cash-flow statement based on a minimum layout defined by the Directive, e.g. requiring operating, investing, financing cash flows? ☒ YES ☐ NO ☐ Don't know. Please comment: …

If the Directive will require a cash-flow statement it would be appropriate to define also a minimum layout to ensure comparability among Member States.

Question 14

If you are a preparer, have you provided a cash-flow statement in the past years? ☐ YES ☐ NO ☐ Don't know. Please comment: …

Could you indicate how burdensome cash flow statement is/will be to your company? ☐ Not burdensome ☐ Significant burden ☐ Don't know. Could you quantify? (in € or % of turnover).

Not applicable.

Question 15

If you are a bank or credit provider, how useful would a cash-flow statement be? ☐ YES ☐ NO ☐ Don't know.

Not applicable.

Question 16

Is there currently a requirement in your jurisdiction to provide a cash-flow statement? ☒ YES ☐ NO ☐ Don't know. Please comment: …

Cash-flow statements are required for separate financial statements of listed companies and consolidated financial statement of non-listed groups.

Question 17

Do you think that small companies should be exempted from the requirement to publish their accounts? ☒ YES ☐ NO ☐ Don't know. Please comment: …

No further comment.

Question 18

Do you think there should be a Member State option to allow small companies only to prepare abridged accounts only? ☐ YES ☒ NO ☐ Don't know.

We think that there should not be a Member State option because abridged accounts provide users with less useful and understandable information. Especially the information given in the profit and loss statement is the basis for banks/creditors to assess the ability to service loans by means of generating sustainable profits, which is the key information when deciding on granting loans.

Furthermore, we believe that the preparation of abridged accounts would reduce the costs of preparing accounts to a very limited extent only because the companies have to assess and process the same scope of business transactions, in terms of numbers and complexity, irrespectively whether they prepare non-abridged or abridged accounts.

Question 19

If you are a preparer, what is the annual cost of publishing your accounts? (in € or % of turnover).

Not applicable.

Question 20

Do you have comments on the role of electronic tools and gateways, e.g. XBRL, in this context (costs - benefits)? Can you provide us with practical experience from your Member State?

For public authorities: Is it possible in your country to file using XBRL? ☐ YES ☐ NO ☐ Don't know. Can you quantify costs of developing an XBRL system in your country?

For preparers: Can you quantify the initial costs of switching to XBRL reporting?

After the initial costs, have you seen reduction of reporting costs (please quantify €, % of turnover)?

For users: Can you quantify the benefits of having access to XBRL reports?

In Germany the legal representatives of companies shall file the annual financial statements with the commercial register of the company's domicile. This can be done using XBRL.

Question 21

Should there be one XBRL taxonomy developed on the EU level? ☐ YES ☒ NO ☐ Don't know. Please comment: …

In our view a harmonised XBRL taxonomy is as desirable as harmonised accounting requirements. Harmonised accounting requirements at the EU level would indeed be a necessary precondition for a harmonised XBRL taxonomy. However, the Accounting Directives do provide for a minimum of harmonisation only because within this framework a broad range of local GAAPs is allowed and applied. We therefore believe that at current the Accounting Directives don't provide a sufficient basis for a harmonised XBRL taxonomy.

Question 22

Do you believe that the Directive should provide prescriptive formats (layouts) for the balance sheet and the profit and loss account? ☒ YES ☐ NO ☐ Don't know. Please comment: …

The GASB does not favour too prescriptive formats as they might not fit all companies.

However, in the above mentioned study on the ED-IFRS for SMEs we also have asked banks which kind of financial presentation they would prefer. The following excerpt of our study (see pages 17 and 18) demonstrates that banks are strongly in favour of prescriptive formats. With regard to the profit and loss account they prefer the nature of expense method rather than the cost of sales method.

"As the ED-IFRS for SMEs does not prescribe any particular balance sheet structure (besides the general principle of classifying the items according to whether they are current or non-current; see ED-IFRS for SMEs 4.5) the interviewees were asked about their expectations for a balance sheet presentation that would fulfil their needs in order to carry out an effective solvency analysis. Many of them supported the idea to distinguish between current and non-current and therefore a structure based on the maturity of the items. In addition to this many expressed their wish for one uniform presentation format that is transparent and clear as most important for their needs, and safeguards so that identical economic issues are presented under the same balance sheet item by all entities. This would increase the efficiency of performing the analysis as further research regarding specific items could be significantly reduced. Additionally, displacing information into the notes should be avoided due to the fact that the analysis of the notes involves greater efforts than using the standardised information on the face of the balance sheet.
Asked about their preferences with regard to the classification of the expenses in the income statement according to the nature of expense (nature of expense method) or the function of expense (cost of sales method) the majority of 64% of the interviewees rated the nature of expense method as more useful than the cost of sales method (Figure 1). In interpreting this result, it must be considered that the classification based on the nature of expense is the traditional and still most practiced one when presenting income statements in Germany. However, as the bankers interviewed explained, their assessment is not primarily triggered by this fact but by their conviction that information about the nature of expenses is more useful for their analysis than information about the function of expenses, and it is more practical for them to have this information on the face of the income statement than set out somewhere in the notes."

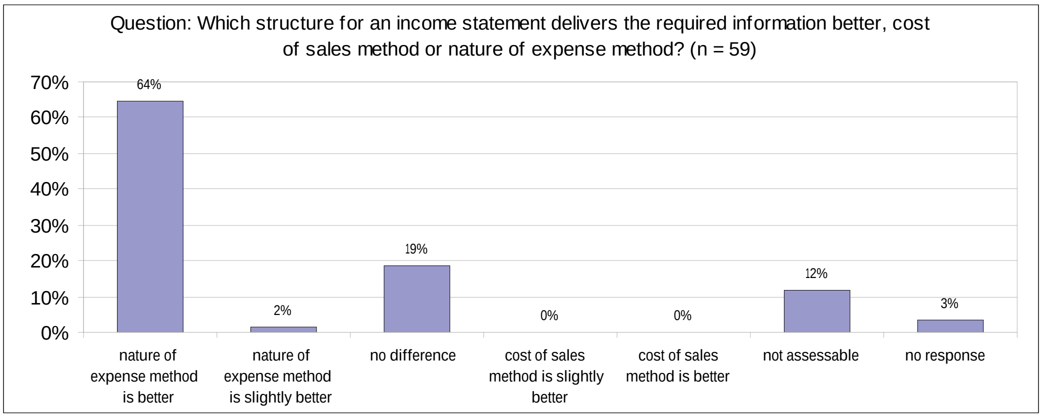

Figure 1: Income statement presentation – cost of sales method versus nature of expense method

Question 23
Should the number of available layouts be reduced? ☒ YES ☐ NO ☐ Don't know. If yes, which layouts should be kept?

As mentioned above (see Question 22) banks as the main users of these financial statements prefer the nature of expense method. On the other hand, especially for industrial companies the sales method can be the more appropriate approach to present their profit and loss figures. We therefore would propose to keep on allowing both methods.

Question 24
Would it be sufficient to provide for a minimum structure for each, the balance sheet and the profit and loss account? ☐ YES ☒ NO ☐ Don't know. Please comment. If yes, can you please provide the key elements of such a minimum structure?

We do not think that a minimum structure is the right way to harmonise the accounting requirements on an EU level. Moreover, our above mentioned study proves that the main users are in favour of a detailed structure because this enables them to analyse the financial statements more easily.

Question 25
What modernizations or amendments would you recommend to the current layouts?

No comment.

Question 26

Do you have comments on the idea to require only a limited number of key financial data from small enterprises instead of a fixed balance sheet and profit and loss account structure? Please comment: …

If yes, which key figures would you regard as absolutely essential?

We do not think that only a limited number of key financial data are sufficient to meet the information needs of users. In addition, we believe that our argument given in the second paragraph of our response to Q15 equally applies with regard to the idea presented herein, i.e. no major simplification effect.

Question 27

Do you believe that the separate line items for extraordinary effects should be removed? ☐ YES ☒ NO ☐ Don't know. Please comment: …

If you are a preparer, can you please indicate how often you used the separate line item "extraordinary items" during the past years?

The GASB believes that information should be provided enabling the prediction of sustainable income. We asked the banks in our above mentioned study (see pages 18 and 19) about their views on the non-presentation of "extraordinary items" (as expressed in ED-IFRS for SMEs 5.6). The study supports our view.

"With regard to the non-presentation of "extraordinary items" the reaction was very negative as demonstrated in Figure 2. A vast majority of 82% expressed their strong opinion that the information about extraordinary items is absolutely indispensable. Bankers explained that they need this information to calculate a prediction of sustainable future cash flows, which is not influenced by extraordinary and (it may be) short term effects. The background is that banks are deeply interested in the future debt service coverage and for that purpose the cash flows from ordinary activities are decisive. Regarding the separate presentation of extraordinary items in the income statement the interviewees stated unequivocally (75%) that a prohibition would involve a lot of additional costs in identifying the extraordinary effects. On the one hand they would have to disaggregate the provided information and on the other they would have to consult the customer in order to prepare additional data. Furthermore, most of the interviewees requested a more specific regulation for extraordinary items and very detailed guidelines on classifying them.

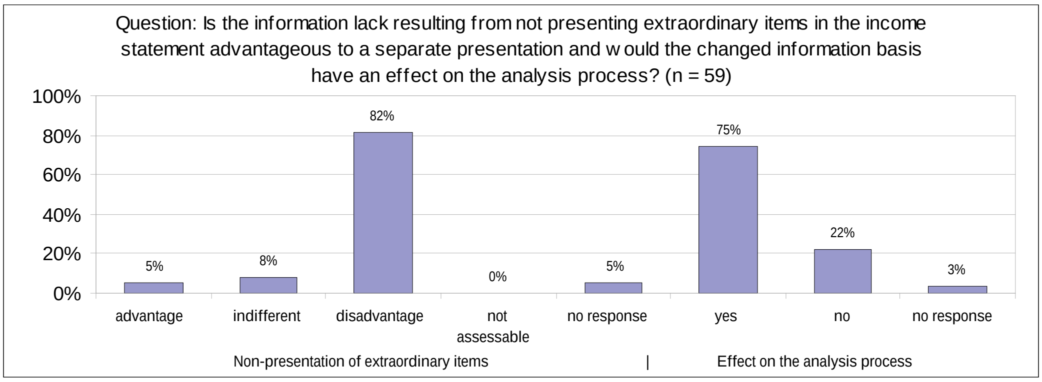

Figure 2: **Advantageousness of not presenting extraordinary items separately and effect on the analysis process**

…"

Question 28

If you are user, do you find the extraordinary item useful? ☒ YES ☐ NO ☐ Don't know. Please comment: …

See answer to Question 27.

Question 29

Are there any other items that should be disclosed for small entities? Can you please indicate additional disclosure requirements for medium-sized and large entities? Please comment: …

With regard to disclosures independent of the size of the company the bankers in our above mentioned study (see pages 19 – 21 and 27 – 29) assessed the following information as being of considerable importance: transactions with related parties, amount and structure of equity, nature of expenses, existence and content of covenants, pledged inventories, write-downs and reversals of write-downs of inventories and business combinations. Furthermore they are in favour of a disclosure of maturities of accounts payable and receivable and of revaluation gains and losses of a period.

The following table show with regard to the assessment of creditworthiness which disclosures are considered by banks to be important, not important, or neither of both (i.e. indifferent):

Importance of disclosures in view of information benefits for the credit decision	*important*	*indifferent*	*not important*
Notes about equity (n = 59)	80%	6%	12%
Notes about the nature of expenses when cost of sales method is applied (n = 59)	86%	2%	2%
Notes about covenants (n = 59)	86%	12%	0%
Notes about breaches of loan agreements (n = 59)	93%	3%	2%
Notes about inventories pledged to securities (n = 59)	93%	3%	2%
Notes about write-downs/reversals of write-downs of inventories (n = 59)	90%	8%	0%

Notes about recognised and expected tax expense (income) (n = 59)	42%	27%	19%
Notes about business combinations (n = 59)	73%	12%	7%
Notes about relations with other group entities (n = 59)	93%	2%	3%
Notes about the management (n = 59)	78%	17%	3%
Notes about transactions with owners (n = 59)	96%	0%	2%
Notes about transactions with other related parties (n = 59)	58%	25%	14%

Table 2: Importance of specific disclosures in view of information benefits for credit decisions

Question 30

What information has to be compiled especially for preparing the disclosures? Can you say anything about the costs of preparing this information? Please comment: …

Relevant information not available.

Question 31

Can you please indicate whether other disclosure requirements in the Directives are not useful and relevant? Can you also provide indications of costs of their preparation (% of turnover)? Please comment: …

No comment.

Question 32

Do you see any potential for modernisation and simplification in the area valuation rules? ☐ YES ☐ NO ☒ Don't know. Please comment: …

The modernisation and simplification of the valuation requirements is an important and challenging issue which in our opinion requires comprehensive discussions. We believe that this cannot be achieved within the given timeframe of this project.

Question 33

Which of the valuation requirements should be more/less descriptive? Please comment: …

No comment.

Question 34

Do you agree with the idea of integrating the Seventh Directive into the Fourth Directive? ☒ YES ☐ NO ☐ Don't know. Please comment: …

No further comment.

Question 35

Do you think there is a need for amendments or modernisation of the Seventh Directives? Could you indicate the areas where a revision would be particularly welcome? ☐ YES ☐ NO ☒ Don't know. Please comment: …

No further comment.

Question 36

Do you believe that there is a need to streamline and modernise the wording and terminology throughout the Directives? ☒ YES ☐ NO ☐ Don't know. Please provide examples: …

We do not see a possibility to streamline and modernise the wording and terminology throughout the Directives without changing the Directives in a more significant manner. Although there is room for such improvements, we believe that this cannot be reached within the given timeframe of this project.

Question 37

Do you have any comments relating to the long-term role of the EU Accounting Directives? Please comment: …

We support the European Commission in its objective retaining the Accounting Directives as the legal framework for non-listed companies. In our opinion these Directives could be further developed into a comprehensive and independent framework to meet the accounting needs of European non-listed companies; however all Member States would need to agree on this goal.