Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany
® Der Standardisierungsrat

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Berlin, 31 January 2011

Dear Françoise,

Request for Views on Effective Dates and Transition Methods

On behalf of the German Accounting Standards Board (GASB), I am writing to comment on EFRAG's draft comment letter on the IASB's Request for Views on Effective Dates and Transition Methods. We appreciate the opportunity to comment on EFRAG's draft comment letter.

For our arguments, please see the appendix (comment letter to the IASB) attached to this letter.

If you would like to discuss any aspect of this comment letter in more detail, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

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Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Berlin, 31 January 2011

Dear David,

Request for Views on Effective Dates and Transition Methods

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the IASB's Request for Views on Effective Dates and Transition Methods (herein referred to as 'RfV'). We appreciate the opportunity to submit our views.

The GASB has carried out some outreach activities among its German constituents prior to finalising this comment letter. Based on the feedback received and our discussions held, we support a single date approach for the major projects (including *Financial Instruments*, *Fair Value Measurement*, *Insurance Contracts*, *Revenue Recognition*, *Leases*, *Consolidation* and *Joint Arrangements*) with a mandatory effective date not before 1 January 2015. Early adoption should be allowed for all standards so that entities that do not have the capacities to implement all the new requirements at the same time can choose an implementation sequence suitable for them. We acknowledge that this approach will result in temporarily restricted comparability.

With regard to the required lead-time for implementing the new requirements there is a consensus that on average two to three years are needed given the expectation that major changes in the entities' IT infrastructure will be necessary.

Our views are provided under the assumption that the finalised standards will be issued by the IASB in 2011 in accordance with the current work plan.

Please find our detailed comments on the questions raised in the RfV in appendix 1 to this letter. If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

Appendix 1

Question 1

Please describe the entity (or the individual) responding to this Request for Views. For example:

(a) Please state whether you are primarily a preparer of financial statements, an auditor, or an investor, creditor or other user of financial statements (including regulators and standard-setters). Please also say whether you primarily prepare, use or audit financial information prepared in accordance with IFRSs, US GAAP or both.

(b) If you are a preparer of financial statements, please describe your primary business or businesses, their size (in terms of the number of employees or other relevant measure), and whether you have securities registered on a securities exchange.

(c) If you are an auditor, please indicate the size of your firm and whether your practice focuses primarily on public entities, private entities or both.

(d) If you are an investor, creditor or other user of financial statements, please describe your job function (buy side/sell side/regulator/credit analyst/lending officer/standard-setter), your investment perspective (long, long/short, equity, or fixed income), and the industries or sectors you specialise in, if any.

(e) Please describe the degree to which each of the proposed new IFRSs is likely to affect you and the factors driving that effect (for example, preparers of financial statements might explain the frequency or materiality of the transactions to their business and investors and creditors might explain the significance of the transactions to the particular industries or sectors they follow).

The GASB is an independent standardisation board established by the Accounting Standards Committee of Germany (ASCG). The ASCG was recognised as the official standardisation organisation for Germany by the Federal Ministry of Justice in a Standardisation Agreement dated 3 September 1998[1]. Its statutory duties under section 342(1) of the German Commercial Code are

- to develop recommendations (standards) for the application of group accounting principles,

[1] This agreement has been terminated effective 31 December 2010. A new agreement is currently under negotiation.

- 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, and
- to develop interpretations of international financial reporting standards within the meaning of section 315a(1) of the German Commercial Code

The GASB, respecting a process of public consultation and in part with the support of its working groups, issues the following technical documents:

- German Accounting Standards (GASs),
- comment letters addressed to national and international bodies dealing with accounting matters,
- discussion papers, and
- other statements and publications, as the GASB sees fit.

Question 2

Focusing only on those projects included in the table in paragraph 18 above:

(a) Which of the proposals are likely to require more time to learn about the proposal, train personnel, plan for, and implement or otherwise adapt)

(b) What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?

The GASB being a national standard-setter is not in a position to make concrete statements in respect of the required time and expected costs of applying the proposed new requirements for each of the projects included in this RfV. The required lead-time and expected costs depend heavily on the nature of each particular entity, e.g. its size, the industry it operates in as well as its level of diversification. Nevertheless, we are able to provide some general comments. We believe that the changes resulting from the new requirements will be so extensive that they can be hardly applied without using adapted software programmes. Starting to develop such programmes while the new requirements are still in an Exposure Draft status is unlikely to happen. The time required for developing new software depends also on how big the differences between the current standards and the new requirements will be, i.e. if the current programmes' functionalities are sufficient and, thus, mainly amendments or extensions are needed or if new functionalities are necessary. For example, the proposals for revenue recognition will lead to a disconnect between the invoiced amount and revenue recognised in the statement of comprehensive income, so that a software programme based on invoiced amounts may no longer be appropriate for financial reporting and would have to be replaced by a new one yet to be developed.

In addition, when the necessary new software platform is available, it has to be implemented at each entity. The timing and resulting costs are dependent, among other things like the size of the entity, on the capacity and availability of the entity's internal IT department.

The GASB undertook some outreach activities among its German constituents before finalising this comment letter. Several entities agreed that applying the new requirements will demand major changes in their IT infrastructure. Some entities assess this implementation project as being more extensive than the first-time adoption of IASs/IFRSs in 2005. Overall, there is a consensus that the average lead-time for applying the new requirements will encompass two to three years once the new requirements have been finalised. The GASB believes that particularly for smaller companies or subsidiaries of bigger companies the resources available will often not be sufficient to adequately handle the challenge of applying all the new requirements at once.

Furthermore, the resources, even of big companies, will be limited due to changing requirements in other areas currently under way, e.g. Basel III demands for financial institutions or Solvency II for insurers. Another issue worth mentioning is that all financial institutions in Germany preparing IFRS financial statements have to file their regulatory declarations based on IFRS figures starting 1 January 2016; the exception to use German GAAP figures will be eliminated by then. As a consequence, it is advisable for them to finalise implementing IFRS 9 before that date.

Question 3

Do you foresee other effects on the broader financial reporting system arising from these new IFRSs? For example, will the new financial reporting requirements conflict with other regulatory or tax reporting requirements? Will they give rise to a need for changes in auditing standards?

As mentioned in our answer to question 2 above, the proposals for revenue recognition have a tendency to result in a disconnect between the invoiced amount and revenue recognised in the statement of comprehensive income. We think that this will affect the handling and recording of VAT on sales, which is usually based on the nominal invoiced amount.

Entities listed in the US are required to present three comparative periods in their financial statements resulting in additional efforts when retrospective application is required. Although those requirements have not been finalised by the IASB or the FASB, we would like to initiate the discussion whether presenting three comparative periods is really necessary.

Question 4

Do you agree with the transition method as proposed for each project, when considered in the context of a broad implementation plan covering all the new requirements? If not, what changes would you recommend, and why? In particular, please explain the primary advantages of your recommended changes and their effect on the cost of adapting to the new reporting requirements.

For our comments on the proposed transition methods for each project, we refer to our respective comment letters. For ease of reference we have listed excerpts from those comment letters regarding comments on proposed transition methods in appendix 2 of this letter. In the context of a broad implementation plan covering all the new requirements we anticipate practical problems for preparers as most of the new requirements include full or limited retrospective application. When retrospective application might already be burdensome for a single new standard for at least some entities, it will be for sure challenging when requiring it for the majority of the projects covered by this RfV. Therefore, the GASB believes that considering a limitation of comparative information or requiring prospective application could be necessary bearing in mind what that means to comparability.

Question 5

In thinking about an overall implementation plan covering all of the standards that are subject of this Request for Views:

(a) Do you prefer the single date approach or the sequential approach? Why? What are the advantages and disadvantages of your preferred approach? How would your preferred approach minimise the cost of implementation or bring other benefits? Please describe the sources of those benefits (for example, economies of scale, minimising disruption, or other synergistic benefits).

(b) Under a single date approach and assuming the projects noted in the introduction are completed by June 2011, what should the mandatory effective date be and why?

(c) Under the sequential approach, how should the new IFRSs be sequenced (or grouped) and what should the mandatory effective dates for each group be? Please explain the primary factors that drive your recommended adoption sequence, such as the impact of interdependencies among the new IFRSs.

(d) Do you think another approach would be viable and preferable? If so, please describe that approach and its advantages.

The GASB acknowledges that the sequential approach tries to reduce the challenges for preparers in implementing the new requirements. However, we see the following difficulties. For some industries it is necessary and adequate that certain new standards are applied together. Finding an appropriate adoption sequence as well as grouping the new IFRSs in a way that will fit for all or a majority of IFRS preparers does not appear to be realistic. Building groups with different adoption dates might lead to clashes with future outcome of post June 2011 projects of the IASB, i.e. instead of avoiding or minimising expected problems, these are simply postponed.

Based on the feedback received, the GASB supports a single date approach for the major projects including *Financial Instruments*, *Fair Value Measurement*, *Insurance Contracts*, *Revenue Recognition*, *Leases*, *Consolidation* and *Joint Arrangements*. In light of the expected lead-time for applying all the new requirements (see our answer to question 2), we would propose a mandatory effective date being 1 January 2015 as the earliest. This should include the phases of IFRS 9 already finalised and assumes that the respective projects will be finalised in accordance with the current work plan. The main arguments for this approach are that cross-cutting issues between the different projects are best covered by such a big bang approach and the advantages of adjusting the systems, training employees, informing analysts and communicating the effects of applying the new requirements internally and externally only once. Given the expected lead-time of two to three years requiring an earlier effective date does not seem to be feasible, even though this conflicts with requests to introduce the new requirements – in particular for financial instruments – as soon as possible to address weaknesses revealed by the financial crisis.

The project *Post-employment benefits – Defined benefit plans* has - in our opinion - a smaller impact on preparers and users as well as less interrelations with the above mentioned bigger projects and can, thus, be implemented in the short term independent from those projects (e.g. with an effective date 1 January 2013). The same applies to the project *Presentation of items of other comprehensive income* if the final standard contains the limited amendments proposed in the ED only. We refer to our comment letter dated 29 September 2010 in which we disagreed with the proposals and preferred a more comprehensive project on the substantial issues of financial statement presentation.

Question 6

Should the IASB give entities the option of adopting some or all of the new IFRSs before their mandatory effective date? Why or why not? Which ones? What restrictions, if any, should be on early adoption (for example, are there related requirements that should be adopted at the same time)?

The GASB believes that entities should have the option to adopt all of the new IFRSs before their mandatory effective date. As mentioned above, several entities do not have the capacities to adopt all the new requirements at the same time. By allowing early adoption, each entity will be able to find a sequence for adopting the new requirements that best fits its available internal and external resources.

Opponents of this view argue that allowing early adoption will reduce comparability of financial statements across entities. Others have concerns that allowing early adoption will result in peer pressure when individual entities apply certain new requirements before their mandatory effective date. We acknowledge those arguments. However, considering the expected average lead-time of two to three years for implementing the new requirements we believe that the time frame of having reduced comparability will be rather short and therefore should be acceptable. For the same reason we do not believe that peer pressure will be a major issue.

Question 7

Do you agree that the IASB and FASB should require the same effective dates and transition methods for their comparable standards? Why or why not?

It is our understanding that the term comparable standards refers to those projects only where the IASB and the FASB either published a joint exposure draft or the requirements of each respective standard are largely converged. Having said this, the GASB strongly agrees that the same effective dates and transition methods should be required for those standards as convergence was repeatedly named as an important objective by the G20 and other organisations. We are well aware that entities listed in the US have to present three comparative periods in their financial statements, so that different transition methods might be appropriate in light of practicality.

For projects having different starting points or different timing with regard to future deliberations, we prefer that the IASB sets different effective dates (and transition methods) rather than waiting until convergence might be reached.

Question 8

Should the IASB permit different adoption dates and early adoption requirements for first-time adopters of IFRSs? Why, or why not? If yes, what should those different adoption requirements be, and why?

Following our proposed approach – single date approach with early adoption allowed – there is no need for different adoption dates and early adoption requirements for first-time adopters. If adopting a new IFRS does not require more efforts than adopting the current standard, first-time adopters are able to adopt the new IFRSs right from the start to avoid further costs in the future to switch from the current to the new standard. On the other hand, if adopting a new IFRS is more complex, time-consuming and costly than adopting the current standard, a first-time adopter can adopt the current standard at the date of transition to IFRSs (to not further expand the first-time adoption efforts) and adopt the new standard when it becomes effective at the latest.

Appendix 2

Project	Proposed transition	GASB comment
Financial Instruments (IFRS 9) – Phase 2 Impairment	Retrospective	The GASB understands and agrees with the reasoning why the IASB proposed neither fully retrospective nor fully prospective application of the new requirements of the ED. We also understand the reasons why the IASB rejected the alternative transition approach. It is our impression that in the eyes of the IASB a transition approach should meet two objectives: to recognise an adequate bad debt allowance (contractual cash flows not expected in the future) at the transition date and to ensure correct revenue recognition (interest revenue) in future periods. The GASB believes that – as this is an ED on amortised cost and impairment – the focus should be placed on the bad debt allowance. Therefore, we prefer the alternative transition approach, which will reduce implementation issues. The fact that the proposed transition approach in the ED is also an approximation affirms our view.
Insurance contracts	Limited retrospective	We disagree with the IASB proposed transition requirements to recognise any positive or negative difference arising from the transition "calculation" in opening retained earnings of the earliest period presented. The approach that an insurer should, on first applying the new IFRS, measure its existing contracts at that date by setting the residual margin equal to zero does not fairly reflect the performance of the insurer. As a consequence, for contracts in force, when the new IFRS comes into effect, an insurer will not recognise residual margins as income for any subsequent period. The insurer will recognise income arising from the release of residual margins only for contracts recognised initially after adopting the IFRS. In our view, such a treatment prevents insurers from reporting a significant part of the profits on existing contracts through profit and loss and reduces comparability between the results on existing and new business. Especially for long-term insurance contracts, we considered that the proposed transitional rules do not provide relevant and comparable information for many years and may reduce the usefulness of financial

		statements. Therefore, we propose an accounting treatment which is in line with IAS 8 'Accounting Policies, Changes in Estimates and Errors' and allows an insurer to apply the new standard retrospectively. We understand the Boards' arguments against retrospective application and the concerns that the insurer would need to estimate the future cash flows as if it had estimated them at initial recognition of the contracts and that this exercise may be burdensome. However, we do not believe that this approach causes costs that are disproportionate to the resulting benefit for users in all cases. To the extent that this would be impracticable, we propose, in line with IAS 8, to allow a simplified approach by means of using a reasonable approximation for a retrospective application. We consider an approach, which compares the liability under current GAAP with the present value of the fulfilment cash flows at the beginning of the earliest period presented. One part of the calculated transition difference that is driven by different accounting treatments between old GAAP and new GAAP should be covered within retained earnings. From a practical point of view, we considered that it would not be consistent with a simplified approach to determine all effects that are driven by different accounting treatments as such a requirement would be burdensome and costly. We therefore propose to only reflect the different discounting effects. The remaining difference would be recognised in the residual margin and released over the remaining coverage period. We generally understand the Boards concerns on the approach to treat the whole transition difference as residual margin as outlined in BC249. The Board rejected the approach because the resulting residual margins would not have been comparable with residual margins for subsequent contracts and would have depended significantly on the pattern of income recognition under previous accounting models. Therefore, we propose to record the effects of different discounting within retained earnings. We acknowledge the deficiencies of our simplification approach. However, in our view, the proposed IASB transition approach provides even less comparability with subsequent contracts, because an

		insurer will not recognise any residual margins as income for subsequent periods. **Transition for short-duration contracts** Transition for short-duration contracts can also be relevant, but there are no transition requirements in the current proposals: the ED should also include guidance on transition for those contracts.
Leases	Limited retrospective	While we agree with the simplified retrospective approach as proposed by the IASB, we suggest additionally permitting (without requiring!) full retrospective application of the new requirements. The main reason for this is that lessors under the derecognition approach (ED.95(b)) at the date of initial application should recognise the residual asset at fair value determined at the date of initial application. However, for underlying assets in use it may be challenging and burdensome to determine the fair value as described above, while it may be more practical (in accordance with a full retrospective approach) to go back to the initiation of the lease, since the fair value in that case simply may be derived from the purchase costs of the underlying asset. With respect to IFRIC 4 *Determining whether an Arrangement contains a Lease* we noted that similar but not identical guidance has been incorporated into ED.B2-B4. In our view, that similar but not identical guidance should not result in a requirement that entities should re-consider agreements that had already been appropriately evaluated under the current guidance of IFRIC 4. Preparers need adequate lead time to prepare for application of the new guidance for lease accounting once the IASB issues the new standard. Specifically, contract management, internal work-flows and processes as well as IT environments need to be adjusted and prepared for the new guidance and to allow for a smooth transition. There is no guidance on the transition for sale and leaseback arrangements in the ED. We ask the IASB to address also this issue so that an entity will be required to determine whether a sale has occurred in the past based on IFRS applicable at that time. Only the lease part of the transaction should be accounted for under either the simplified or full retrospective approach as proposed in the ED.

Revenue from contracts with customers	Retrospective	The GASB agrees that comparability and preserving trend information about revenue is important for users of financial statements and therefore understands the proposed retrospective application of the new requirements. As the proposals represent quite a fundamental change to the current revenue recognition model, a fully retrospective application would also prevent revenue being recognised twice or not at all. On the other hand, we see huge burdens in retrospectively applying these requirements for entities which have non-standardised complex contracts and/or are currently applying the percentage of completion method in IAS 11 to a large extent, which in our opinion will decrease under the proposed requirements. Furthermore, we think that entities with more complex revenue recognition models will adjust their future contracts with customers to the new requirements. Thus, retrospective application will result in applying the new requirements on contracts that will not be concluded in the same manner in the future anymore so that the desired comparability and trend information will not be achieved. As a result we favour applying the new requirements prospectively.