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

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Berlin, 21 October 2011

Dear Hans,

Exposure Draft ED/2011/2 Improvements to IFRSs

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the IASB Exposure Draft ED/2011/2 óImprovements to IFRSsô(herein referred to as the óEDô). We appreciate the opportunity to respond to the ED under the fourth cycle of the Annual Improvements project.

Our detailed comments on the seven amendments proposed are set out in the appendix to this letter.

We would like to highlight and express our specific concerns with respect to the proposed amendment Repeated application of IFRS 1, for which we consider further differentiation necessary. Requiring the application of IFRS 1 as described in the proposed paragraph 2A to be added to IFRS 1 would lead to situations in which (1) the limited exemptions from full retrospective application of the IFRSs as well as (2) the prohibition of retrospective application in some areas as detailed in IFRS 1 would not be appropriate and justifiable.

> Example: If in a jurisdiction, which normally adopts the IFRSs timely into national GAAP, the adoption of one new standard cannot be achieved before its effective date, the reporting entities in that jurisdiction cannot apply the standard and therefore cannot make an unreserved compliance statement. If in the following year the standard is adopted, the entities would be fully compliant with IFRS, again. However, in accordance with the proposed paragraph 2A, the reporting entities must apply IFRS 1 for this annual reporting period. We consider such a compulsive

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application of IFRS 1 to be out of proportion since it would allow these entities to make use of all exceptions to the retrospective application of IFRSs as detailed in IFRS 1.18 f.

Therefore we propose for the situations in discussion to generally allow full retrospective application of IFRSs, since this approach would ï in any case ï lead to the most useful financial information to users. Further, entities should be allowed to apply IFRS 1 only in case and to the extent, that

- the cost of complying with an IFRS effective at the end of its first IFRS reporting period would likely exceed the benefits to users of financial statements, or
- retrospective application of an IFRS would require judgements by management about past conditions after the outcome of a particular transaction is already known.

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

Yours sincerely,

Liesel Knorr
President

Appendix

General questions ï to be answered individually for each proposed amendment:
Question 1:
Do you agree with the Boardõs proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?
Question 2:
Do you agree with the proposed transitional provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose?

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

- **Repeated application of IFRS 1**

Question 1: We partly disagree with the Boardõs proposal.

On the one hand we support the underlying assertion, that IFRS 1 may (need to) be applied repeatedly, not only once in an entityõs very first IFRS financial statements.

On the other hand we do not support the undifferentiated requirement to apply IFRS 1 ówhen the entityõs most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with IFRSs, even if the entity applied é IFRS [1] in a reporting period before the period reported in the most recent previous annual financial statements.ô

Requiring the application of IFRS 1 in any such circumstances could lead to situations in which the exemptions from requirements in specified areas as granted by the standard would be available to an entity although the cost of complying with these requirements would not likely exceed the benefits (please refer to IFRS 1.IN5 ï sentence 1). Likewise, the application of IFRS 1 in circumstances as described in the proposed paragraph 2A could also lead to situations in which IFRS 1 prohibits retrospective application of IFRSs in some areas, although an entity would not need to make judgements by management about past conditions after the outcome of a particular transaction is already known since these past conditions have been judged continuously over the past periods (without knowing the outcome) (please refer to

IFRS 1.IN5 ï sentence 2). In summary, requiring the application of IFRS 1 in circumstances as described in the proposed paragraph 2A would not in all instances be appropriate and justifiable.

Based on these considerations we recommend setting the requirement for repeated application of IFRS 1 as follows:

1. Each time an entity prepares and presents financial statements that meet the definition of its first IFRS financial statements (even if the entity applied IFRS 1 in a reporting period before the period reported in the most recent previous annual financial statements), it shall be allowed to apply IFRSs in its first IFRS financial statements retrospectively in accordance with IAS 8. This is because we consider such financial statements to be superior (ie providing more useful financial information) as compared to financial statements being prepared by making use of the limited exemptions granted by IFRS 1. If an entity is in a position to follow this approach and wishes to do so, it should not be prohibited to follow this path.

2. Only in case and to the extent
   - the cost of complying with an IFRS effective at the end of its first IFRS reporting period would be likely to exceed the benefits to users of financial statements, or
   - retrospective application of an IFRS would require judgements by management about past conditions after the outcome of a particular transaction is already known,

   an entity shall be allowed to apply IFRS 1 in its first IFRS financial statements.

In other words, an entity shall not be required in any circumstances to apply IFRS 1 in case it prepares and presents financial statements that meet the definition of its first IFRS financial statements, even if the entity has applied IFRS 1 in a previous reporting period.

Based on the following example we would like to illustrate unintended consequences which would occur if our proposed modifications would not be considered:

> In jurisdiction J the IFRSs as issued by the IASB normally are timely adopted into national accounting standards on a ìone-by-oneî approach. In case of a standard IFRS X, however, the adoption cannot be achieved before the effective date as

determined in the standard. Therefore, the reporting entities in J cannot apply IFRS X and cannot make an unreserved statement of full compliance as requested by IAS 1.16 (while they are, at the same time, fully compliant with the national accounting standards in J).

In the following year IFRS X is adopted in J and reporting entities are again in a position to be fully compliant with IFRS. However, in accordance with the proposed paragraph 2A to be added to IFRS 1, the reporting entities in J must apply IFRS 1 for this annual reporting period.

Such a compulsive application of IFRS 1 appears to be out of proportion considering

- that in accordance with IFRS 1.18 f. the reporting entities in J would be allowed to elect using one or more of the exemptions contained in Appendices C-E of IFRS 1,
- while the only departure from full IFRS relates to IFRS X (for which the reporting entities even may be in a position to retrospectively apply the requirements of this standard).

Further, we noticed that the *IFRS for SMEs* para. 35.2 prevents an entity from being a first-time adopter of *IFRS for SMEs* more than once. In this respect ï from a conceptual point of view ï we consider it not being acceptable to have a very restrictive requirement in the *IFRS for SMEs* (para. 35.2), while the IASB intends to set up a corresponding requirement for the repeated application of IFRS 1 which is rather non-restrictive. In this context, we propose that para 35.2 of the *IFRS for SMEs* should be subject to the forthcoming review of SMEsô experience in applying the *IFRS for SMEs* as announced in para. P16 of this standard.

We also suggest that the amendment to IFRS 1 with respect to its repeated application shall be clear as to the fact that the previous GAAP, which is defined in appendix A of IFRS 1 as the ðbasis of accounting that a first-time adopter used immediately before adopting IFRSsô (emphasis omitted), includes IFRS for SMEs.

<u>Question 2</u>: We agree with the proposed effective date (application for annual periods beginning on or after 1 January 2013) and that earlier application is permitted, but must

be disclosed.

- **Borrowing costs relating to qualifying assets for which the commencement date for capitalisation is before the transition date**

<u>Question 1</u>: We agree with the Board's proposal.

<u>Question 2</u>: We agree with the Board's proposal.

IAS 1 *Presentation of Financial Statements*

- **Clarification of requirements for comparative information**

<u>Question 1</u>: We agree with the Board's proposal.

<u>Question 2</u>: We agree with the Board's proposal.

- **Changes to reflect the *Conceptual Framework for Financial Reporting 2010***

<u>Question 1</u>: We disagree with the Board's proposal.

Rather, we propose the following:

(1) In principle, the completion of a phase in revising the *Conceptual Framework* should (simultaneously) result in *consequential amendments* to IFRSs – not only considering IAS 1 (with specific concern we make reference to IAS 8.10 (b), which still refers to 'reliability' as one of the four principal qualitative characteristics of financial statements as postulated in the Framework approved in July 1989 by the IASC and adopted in April 2001 by the IASB).

(2) While we acknowledge that the implementation of such *consequential amendments* practically will be challenging, we alternatively would consider it acceptable to reflect the necessary amendments of the IFRSs in a timely manner.

(3) Disregarding of whether the above approach (1) or (2) will be applied, we consider it necessary that the changes of the IFRSs also provide effective dates and guidance with respect to the transition of the new requirements.

(4) With regard to the specific changes the IASB proposes to reflect the *Conceptual Framework for Financial Reporting 2010* that was issued in September 2010, we hold the opinion that IAS 1 does not need to address any guidance depicted in the *Conceptual Framework* referring to óunderstandabilityô (here: QC32) and the óobjective of financial reportingô. Therefore, we suggest deleting any such (repeating) guidance in IAS 1.

Beside the above, we noted that the proposed changes to IAS 1 with respect to the update of the óobjective of financial statementsô to be the óobjective of financial reportingò is likely to cause changes to IAS 1.19, .20, .23 and .24. However, the ED does not indicate such changes. We understand that the IASB may consider these changes as editorial consequential changes not being significant enough to be part of the ED. However, we consider it necessary to indicate in the ED all changes which will be triggered by AIP in order to have full visibility and do not support the omission of any changes in the context of AIP in the ED.

<u>Question 2</u>: Please refer to the above answer to question 1 ï number (3).

IAS 16 *Property, Plant and Equipment*

- **Classification of servicing equipment**

<u>Question 1</u>: We agree with the Boardõs proposal.

<u>Question 2</u>: We agree with the Boardõs proposal.

IAS 32 *Financial Instruments: Presentation*

- **Income tax consequences of distributions to holders of an equity instrument, and of transaction costs of an equity transaction**

<u>Question 1</u>: In general we agree with the Boardõs proposal to address the perceived inconsistency between IAS 12 and IAS 32 regarding the recognition of income tax relating to both dividend distributions to holders of an equity instrument and transaction costs of an equity transaction. Specifically we support the approach to amend IAS 32 to

clarify that income tax relating to such distributions and transaction costs should be accounted for in accordance with IAS 12.

However, by referring in IAS 32 to IAS 12 with respect to the recognition of income tax relating to dividend distributions to holders of an equity instrument, it might still not be clear how to recognise such income tax:

- On the one hand it could be concluded that IAS 12.52B needs to be applied, which requires the recognition of the income tax consequences of dividends in profit or loss.
- On the other hand, IAS 12.52B states that óthe income tax consequences of dividends are recognised in profit or loss for the period as required by [IAS 12] paragraph 58 <u>except</u> to the extent that the tax consequences of dividends arise from the circumstances described in [IAS 12] paragraph 58(a) and (b)ô(emphasis added). IAS 12.58 (a) establishes an exemption from the basic requirement (recognition of income taxes in profit or loss): when taxes arise from óa transaction or event which is recognised, in the same or a different period, outside profit or loss é directly in equity (see [IAS 12] paragraphs 61A to 65)ô According to IAS 12.61A, in such instances current tax shall be recognised directly in equity, when the item it relates to is recognised directly in equity.

Therefore, we suggest that the IASB addresses this issue within IAS 12 in the course of its Annual Improvements Process in order to clarify what the appropriate treatment under this standard is. A separate project to address this issue is not considered necessary.

<u>Question 2</u>: We agree with the Boardôs proposal.

IAS 34 *Interim Financial Reporting*

- **Interim financial reporting and segment information for total assets**

<u>Question 1</u>: We agree with the Boardôs proposal.

<u>Question 2</u>: We do not agree with the Boardôs proposal of prospective application.

Rather, we propose to require that an entity shall apply that amendment retrospectively for annual periods beginning on or after 1 January 2013 (with earlier application to be permitted). In case of changes with respect to segment information used in the management reporting system causing the measurement of total assets for a particular reportable segment to be different as compared to the past, an entity would need to recalculate ótotal assets for this reportable segmentô for reporting purposes in its first financial statements in which it applies the proposed amendment to IAS 34 (as information referring to the previous period). We consider this requirement to be undue and burdensome since this information is not regularly provided to the chief operating decision maker. Thus, the recalculation has to be made only in order to provide a previous period information while no comparable information for the current reporting period is required. Accordingly, we propose retrospective application of the suggested amendment.