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Mr Hans Hoogervorst
Chairman of the
International Accounting Standards Board
30 Cannon Street

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United Kingdom

Düsseldorf, 25 October 2011
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Dear Mr Hoogervorst

Re.: IASB Consultation Paper "Agenda Consultation 2011"

We appreciate the opportunity to comment on the consultation paper mentioned above and would like to submit our comments as follows:

General Remarks

The IDW welcomes the three-yearly public IASB agenda consultation, introduced as a result of the second Constitution Review of the IFRS Foundation in 2010. This kind of agenda-setting process will help the IASB to become better aware of the financial reporting needs of the IFRS users around the world, and we hope that these views will be adequately taken into account when the IASB finally develops its overall strategic direction and balances its agenda over the next three years.

We are aware that the needs and priorities of users are increasingly heterogeneous. This is a result of the large number of countries that have adopted the IFRS within the last years. Appropriate consideration of the overall objectives of the IFRS Foundation and the adherence to the agenda-setting criteria, as set out in the IASB's *Due Process Handbook*, become all the more important when the IASB discusses whether an individual project should be added to its agenda or not. The IASB's reasons for accepting or rejecting each project that has been proposed should be published in order to make the IASB's final decision as transparent and understandable as possible. Transparency of the whole agenda-setting process, including the ability of users to understand how the IASB has reached its final decisions on the agenda is a precondition to achieving the Board's intended enhancement of public accountability and legitimacy of the standard setting process. The final decisions on the agenda as well as the entire agenda-setting process should be monitored by the Trustees.

In the IDW's opinion, the IASB's agenda over the last few years was overly ambitious. We appreciate that it was inevitable for some projects to have to be added at short notice due to the pervading market conditions and political reasons (e.g. the replacement of IAS 39 in consequence of the financial crisis). However, the IASB also initialised some projects that were neither urgent nor necessary in the view of the majority of the users (e.g. the projects *liabilities* and *revenue recognition)*. The primary objective for some projects was to reach convergence, in particular between the IFRS and US GAAP. Experience with those projects initiated in accordance with the Memorandum of Understanding (MoU) has shown that convergence of two basically different financial reporting languages is, in theory, a welcome objective, but at the same time very ambitious and achievable only, if at all, in the long term. Moreover, the current results of the MoU are disappointing: from the former 11 main projects (23 projects all in all) only two have been finalised (IFRS 3; IFRS 13). In all other cases, both boards were either unable to find a common solution (we refer to the projects *consolidated financial statements* and *liabilities)* or they deferred the work, after dividing projects into several phases (e.g. *conceptual framework*, *post-employment benefits)* or the projects remain on the current agenda *(revenue recognition, leases, financial instruments)*. This lack of progress calls the ability and the willingness of the FASB and the SEC to compromise on a common solution with the IASB into question, as well as their willingness to adopt IFRS. Therefore, we agree with the IFRS Advisory Council that convergence should no longer be a prime consideration. Furthermore, no single region or country should be able to have a dominant influence on the new agenda and the Board's priorities. However, the IASB should primarily focus on serving those who have adopted IFRSs. The needs of users from countries that have gained experience in implementing and applying IFRS should be taken into greater account.

Considering the limited resources and time available to the IASB (and IASB staff) as well as the various stakeholder groups, we recommend that the next agenda should contain fewer projects than in recent years. Rather than working on a multitude of projects simultaneously, the Board should focus on a limited number. This would help the Board to avoid being unable to comply with its previously announced timetable, as was the case in the recent past. Too many projects were deferred or divided into and worked on in discrete phases. In our view, it is important for the next agenda to leave some capacity free so that the Board will be able to react to unforeseen developments and take on urgent projects in the short term, if necessary.[1] In this context, we also welcome the Board's intention to build capacity into the agenda for projects of narrow-scope issues that are too broad to be addressed by the IFRS Interpretation Committee.

The development of new standards should not be subject to continuous time pressure. It has to be possible for the Board to undertake comprehensive research and outreach activities as well as field-tests. This is the necessary basis for developing standards that are well considered and sufficiently robust to be able to remain valid for an extended period. The Board should avoid being forced to rectify or amend standards that have been recently published. Otherwise, it will not be possible to reduce the current pace of change nor to enhance the quality of the standards as intended.

In addition, the IDW believes that it would make sense to establish a provision as to when, and under which conditions, current projects should be stopped or even removed from agenda. For example, it may become likely that the scope of an active project will be broader than originally assumed such that the project could not be finished within an adequate period of time and/or the cost-benefit consideration has changed.

We would like to comment on the specific questions as follows:

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[1] For example, some years ago, many jurisdictions implemented *"Emission Trading Schemes"* and created a new financial reporting issue. For this reason, the IASB initiated a new project which should clarify how to present emission trading schemes in the financial statements. This could have been useful, especially for preparers. However, the project was stopped because of the limited resources of the IASB. Hence, users had been forced to develop their own approach. Currently the majority sees no necessity and/or urgency to reactivate the project.

Question 1

What do you think should be the IASB's strategic priorities, and how should it balance them over the next three years?

Given the multitude of new standards which have been finished recently (e.g. IFRS 9 *Classification and Measurement*, IFRS 10, 11, 12, 13) and those which should be finished by the end of the next year (e.g. *impairment of financial instruments, hedge accounting, insurance contracts, leases* and *revenue recognition)*, we generally favour a "period of calm" or moratorium in standard-setting. Users must be granted enough time to implement the new standards without being required to consider new guidance at the same time. We would therefore prefer the IASB establish a *"stable platform"* before embarking on further substantial projects. In this context, the IDW recommends that the Board concentrate on projects in the category *"maintaining existing IFRSs"*.

However, we also believe that it is imperative that the Board complete the *conceptual framework project* as soon as possible in order to have a consistent basis for developing future standards. Besides, we urge the Board to address a comprehensive *disclosure project*. In our view, the *Institute of Charted Accountants (ICAS)* and the *New Zealand Institute of Charted Accountants (NZICA)* report *"Losing the excess baggage – reducing disclosures in financial statements to what's important"* as well as the *Accounting Standards Board (ASB)* report *"Cutting the clutter – Combating clutter in annual reports"* both provide a good starting point for this project, which should be directed at reducing current disclosures and developing a disclosure framework for the IFRS. For further details and explanations, we refer to our answer to question 2(a).

Moreover, the IDW believes that the two following projects, previously added to the IASB's agenda but then deferred, should be reactivated:

a) *performance reporting (incl. other comprehensive income)*
because of the lack of both a definition of performance, and of principles for identifying items to be recognised in other comprehensive income (as opposed to profit or loss) and for "recycling",

b) *business combinations between entities under common control*
because of the considerable diversity in practice.

For further details and explanations, we refer to our answer to question 2(b).

Question 1(a)

Do you agree with the two categories we identified and the five strategic areas within them? If you disagree, how do you think the IASB should develop its agenda, and why?

The IDW agrees with the proposed categorisation of projects into either *"developing financial reporting"* or *"maintaining existing IFRS"* as well as the five strategic areas *(conceptual framework, researching strategic issues for financial reporting, standards-level projects, post-implementation reviews* and *responding to implementation needs)*.

Question 1(b)

How would you balance the two categories and five strategic areas? If you have identified other areas for the IASB's agenda, please include these in your answer.

In our view, both categories – *"developing financial reporting"* as well as *"maintaining existing IFRS"* – are significant in terms of responding to user needs and ensuring the quality of IFRS in the long term. Hence, projects from both categories should generally be placed on the IASB's agenda. In the last few years especially, projects within the category *"developing financial reporting"* were overrepresented on the agenda (see the development of IFRS 9-13). Therefore, we would prefer that the IASB place comparatively more emphasis on projects within the category *"maintaining existing IFRS"* than on projects of the category *"developing financial reporting"*.

In our view, the IASB should use the time inter alia to undertake the *post-implementation reviews* announced, which form a reasonable and necessary part of the *due process* to both reconsider issues that have been contested during the development of an IFRS, and to respond to issues that have revealed unexpected costs or implementation problems in practice. Moreover, we would like to caution the Board that such implementation problems are unlikely to be limited to the most recently finished standards. For example, the determination of the fair value of intangible assets within the purchase price allocation (IFRS 3) and the measurement after recognition of the fair value of investment properties (IAS 40) regularly cause problems in practice and often lead to complaints from auditors and others such as enforcement authorities. Consequently, *post-implementation reviews* in these cases would also be reasonable.

Question 2

What do you see as the most pressing financial reporting needs for standard-setting action from the IASB?

From our point of view, the IASB should focus on finishing the four main projects on its current agenda *(revenue recognition, leases, insurance contracts* and *financial instruments)* first. Afterwards, we would like to propose a period of relative calm in standard-setting. Instead of starting many new projects, the Board should deal with the following projects, which are basically conceptual in nature:

- *conceptual framework*,
- *disclosures* (incl. the development of a disclosure framework),
- *performance reporting* (incl. other comprehensive income), and
- *business combinations between entities under common control*.

Beyond this, the Board should limit itself to projects within the category *"maintaining existing IFRS"*, such as the *post-implementation reviews* or *annual improvements.*

Question 2(a)

Considering the various constraints, to which projects should the IASB give priority, and why? Where possible, please explain whether you think that a comprehensive project is needed or whether a narrow, targeted improvement would suffice?

a) *<u>Conceptual framework</u>*

The *conceptual framework* is an IASB – FASB convergence project. It was added to the IASB's agenda in October 2004. The Boards decided to address the project in eight phases; phase A *"Objectives and qualitative characteristics"* was finished in September 2010, the exposure draft of phase D *"The reporting entity"* was published in March 2010 and the work on three other phases was then in process. However, at the end of 2010, this work was deferred due to other urgent projects.

In relation to the development process of the new framework, the IDW does not support dividing the project into several phases. In our comment letter on the IASB *Exposure Draft of an improved Conceptual Framework for Financial Reporting*, dated 9 September 2008, we suggested that, rather than adopting a piecemeal approach, the Board should publish the final version of the new conceptual framework in one step. This would avoid the situation (currently experienced) in which parts of the extant and the new conceptual framework would be in force simultaneously. Given the complexity of the diverse issues, the phased approach adopted by the IASB will necessarily result in unintended consequences and could lead to new inconsistencies.

The conceptual framework provides guidance to preparers, auditors, regulators and others when there is no specific guidance in an IFRS for a particular transaction or circumstance. Further, the conceptual framework also assists the IASB in setting standards that are principle-based and internally consistent. Therefore, it plays a decisive role within the standard-setting process, from our point of view. However, to date, the development process has shown that the significance of the framework as a conceptual basis for the IASB to draw upon in both developing and amending its standards is apparently not being taken seriously enough. In our view, it should not be possible to develop and publish a new standard like IFRS 10 *Consolidated Financial Statements* without having finalised the discussion of basic terms such as '*control*' or '*reporting entity*' within the new framework.

Consequently, the IDW strongly suggests that the *conceptual framework project* be reactivated and finished as soon as possible. In future, the IASB should only be able to develop or amend standards on the basis of a complete and functioning framework. In this context, we believe that the significance of the framework as the conceptual basis of the IFRS must be enhanced, too. Therefore, we recommend that the IASB's adherence to the final provisions of the framework should also be monitored by the Trustees. This would contribute to improving the accountability of the whole IASB's standard-setting process.

b) *Disclosures*

The notes form an important part of the financial statements and inform *all* users about the financial position, performance and risks of an entity more in detail. However, too much information could impair the informative value and the quality of the financial statements. For example, in Germany, the volume of notes in the financial statements of the 30 public listed entities (DAX) has increased by 30 % on average in the last five years.

The reasons are diverse. On the one hand, the IASB has continuously introduced new disclosure requirements (e.g. IFRS 7, IFRS 8, IAS 24, ...); some of which are necessary to describe increasingly complex economic issues, others of which were only introduced in order to respond to the specific information needs of particular user groups. The latter results in lengthy detailed disclosures that could obscure *really* useful information to the detriment of the majority of users. Another reason for the increased volume of disclosures in the financial statements seems to stem from increased expectations as to how comprehensive the depiction of the financial position, performance and risks of an entity should be. Instead of distinguishing between information that is material and that that is not, preparers tend to include as much as information as possible in order to avoid discussions with auditors and enforcement authorities. All of this has led to excessive disclosures requiring increasingly complex analyses, which are costly and burdensome. Therefore, the IDW welcomed the fact that the IASB asked the *Institute of Chartered Accountants of Scotland (ICAS)* and the *New Zealand Institute of Chartered Accountants (NZICAS)* to undertake a project to review the levels of disclosure requirements in the existing IFRS. As a result, both national standard setters came to the conclusion that a 30 % reduction in the length of financial statements would be possible.

Disclosures within the IFRS should be reduced to a reasonable extent. We also believe that the development of a disclosure framework would be helpful in ensuring that in the future disclosure requirements are only introduced if they are consistent, free of redundancy and provide information that is really useful to the majority of users. Hence, the IDW recommends that the Board start a *disclosure project* as part of its next agenda. We realise that the IASB originally considered this as part of its *conceptual framework project*. However, given its broad scope and the required extent of research activities, we would prefer it be treated as an agenda-project in its own right.

In this context, we would like to point out a further consequence of the increased length and complexity of the financial statements. Preparers are increasingly using more and more *non-gaap financial measures* in their annual reports in order to summarise their financial statement information and to provide users with a quick overview of the financial position and performance of the entity. Such *non-gaap financial measures* are well received by many users as they currently view performing their own analyses of the financial statements and in particular the notes, as too time-consuming, costly and burdensome.

Generally, the usage of key indicators could be one way to help to improve the transparency and comparability. However, the increased number of *non-gaap financial measures* in entities’ annual reports is not without problems for several reasons, including:

- Definitions are often insufficient, if given at all.
- Reconciliations to *gaap measures* are often missing.

- The measures are often entity-specific and not comparable to those used by other entities.
- Sometimes the whole purpose of the measures is not sufficiently clear to users.

In addition, *non-gaap financial measures* have only a limited potential to depict the complex activities and financial conditions of an entity comprehensively. There is also the risk of “window dressing”, i.e. entities present information that has the potential of being received favorably by users, thereby detracting from the real performance and financial position.

We recommend that the IASB address this issue in the project.

Question 2(b)

Adding new projects to the IASB’s agenda will require the balancing of agenda priorities with the resources available.

Which of the projects previously added to the IASB’s agenda but deferred (see table page 14) would you remove from the agenda in order to make room for new projects, and why? Which of the projects previously added to the IASB’s agenda but deferred do you think should be reactivated, and why?
Please link your answer to your answer to question 2(a).

a) *Performance reporting (incl. other comprehensive income)*

At present, no principle has been established in IFRSs for measuring and presenting an entity’s performance. The IDW has previously suggested that the definition of “performance” should be discussed thoroughly within the current *conceptual framework project* (we refer to our comment letter on the IASB ED/2010/5 *“Presentation of Items of Other Comprehensive Income – Proposed amendments to IAS 1”,* dated 21 July 2010).

Currently comprehensive income is divided into two parts – *profit or loss* and *other comprehensive income*. However, neither the extant conceptual framework nor IAS 1 have established a principle for identifying items that should be recognised in other comprehensive income as opposed to profit or loss. Consequently, the IASB’s constituents have often cited a variety of reasons as to why certain gains and losses might be presented in other comprehensive income. For example, they assume that such gains and losses:

- cannot be measured reliably,
- are unrealised,
- refer to long-term assets or liabilities, or
- have no or little predictive value.

In addition, there is no consistent methodology for reclassification to profit or loss in IFRSs (“recycling”). The decisions in this area have been made on a project-by-project basis in the absence of a conceptual basis, sometimes to balance differing opinions, and demonstrate the need for the IASB to review how best to present performance.

As another consequence of the lack of guidance on measurement and presentation of performance, preparers increasingly use *performance indicators* to provide additional insight into the entities' performance. They are often developed in order to inform users about the results of “normal” operations, i.e. results that over time are likely to be sustainable. *Performance indicators* that are commonly used include e.g. EBIT, EBITDA or Free Cash Flow – frequently adjusted for entity-specific extraordinary items and/or non-recurring effects. The increasing usage of such performance indicators also implies that there is a gap between the information needs of the capital market and the information provided under IFRS. Therefore, we recommend that the Board look at the most commonly used *performance indicators* to identify potential shortfalls in the current standards.

The IDW recommends that all of these issues be addressed as a single project *performance reporting (incl. other comprehensive income)* based on thorough deliberations in the context of the *conceptual framework project*.

b) *Business combinations between entities under common control*

Originally, *business combinations under common control* were part of the convergence project *business combinations* between the IASB and the FASB. In 2008, *business combinations under common control* were explicitly scoped out of IFRS 3 in order to avoid deferring the release of that standard. Work on the project *business combinations under common control* was deferred in 2009 as a consequence of the multitude of other (more urgent) convergence projects and the financial crisis.

Since then, due to the absence of specific guidance, entities have had to select an appropriate accounting policy using the hierarchy described in IAS 8. The urgency of such a project becomes apparent when one considers the several organisations who are currently concerned with this issue (e.g. EFRAG, *Korean*

Accounting Standards Board). In addition, the *IFRS Interpretations Committee* has recently affirmed the existing diversity in practice and hence the necessity to develop accounting guidance for *business combinations under common control*. Furthermore, the IFRS IC has approved the compliance of this project with the agenda criteria and encouraged the Board to reactivate it (we refer to the IASB Staff paper 6B, dated July 2011). The IDW also supports this view.

In our opinion, the IASB will require the majority of its resources to meet its *“existing priorities”* and to work on the projects which we have identified above. Therefore, we believe that the decision about reactivating additional projects should be postponed until a later date.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

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