GERMAN ACCOUNTING STANDARDS BOARD (GASB)

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Tom Jones
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Berlin, 15 December 2006

IASB Project: International Financial Reporting Standard for Small and Medium-sized Entities (SMEs)

Dear Mr. Jones,

First of all we would like to thank the IASB for its efforts to develop an IFRS for SMEs. As expressed earlier we fully support this project, which can be considered as one of the main challenges the IASB faces at present.

The IASB has published several Staff Drafts of the ED-IFRS for SMEs (4 August and 9 November 2006), which are not for comment at the moment. While we do not intend to comment on any details of the current staff draft, we would like to point out at this crucial stage of the SME project the paramount issues we believe the ED-IFRS for SMEs will face in Germany. We do acknowledge, however, that our current thoughts are based only on such drafts. Neither did the IASB finalize its deliberations nor were we able to consider the thoughts the IASB will express in a basis for conclusion.

Despite these restrictions we would like to express our major concerns with regard to the acceptance of the ED-IFRS for SMEs in Germany, Europe and probably even worldwide. We understand the difficulties connected with the development of an appropriate IFRS for SMEs and we acknowledge the first result of the working process as an important step towards the right direction. Nevertheless we believe it is necessary to consider several aspects in more detail to receive an appropriate and high quality IFRS for SMEs.

SMEs – defined by the IASB as non-publicly accountable entities – are covering a broad spectrum of entities. Based on this definition an IFRS for SMEs could potentially address the huge group of all non-listed entities that are not acting in a fiduciary capacity. This group will comprise entities of different legal forms (such as limited liability entities but also partnerships with unlimited liability) and entities of very different size. The IASB has said to concentrate on entities with about 50 employees when developing the standard. For these (incorporated or private) entities with about 50 employees the demands of the ED-IFRS for SMEs could still be overly burdensome. On one side the costs to prepare financial statements for smaller entities are relatively higher. On the other side it still seems questionable who the users of these financial statements would be and what their particular needs and therefore benefits could be.

To give an example: in Germany (in accordance with EU directives) incorporated entities with about 50 employees (not partnerships) prepare single accounts with condensed (more aggregated) information in the balance sheet and the profit or loss statement and condensed notes. While we do not believe that financial statements prepared under IFRS for SMEs should be similarly condensed, we believe that the level of acceptance of IFRS for SME will partly depend on the difference between the current reporting requirements and future reporting requirements under IFRS for SME.

While we acknowledge that the IASB has already considered many suggestions (e.g. less fair value requirements if fair value is not readily obtainable) there still seem to be many aspects that the IASB could consider at this stage of the project. Albeit not all-inclusive the following are examples of importance of what we believe needs to be reconsidered to facilitate acceptance the IFRS for SMEs would deserve.

- The IASB has attempted to develop a **stand-alone standard**, which we believe is a favourable approach. Fallbacks to full IFRS are limited to options or standards that address issues not typically relevant for SMEs. However, SMEs will also have to go back to full IFRS if no adequate provision can be found within other sections IFRS for SMEs (analogy) or a provision cannot be deducted from the pervasive principles (par 10.3). Therefore the pervasive principles are crucial in order to avoid regular fallbacks to full IFRS. To our understanding these pervasive recognition and measurement principles could be enhanced and improved in order to fulfil these aims. For example, 2.42 states that “most non-financial assets that an entity initially recognised at historical cost are subsequently measured on other measurement bases.” and gives examples. It only touches on the intended principle, though. It seems the underlying principle (here: “lower of cost or market”) should be elaborated on.
- To our understanding many respondents to the questionnaire required simplifications with regard to the **subsequent measurement of goodwill**. It seems essential that SMEs would be allowed to amortise goodwill over a fixed period of years (e.g. 10, 15 or 20 years). A burdensome impairment test would only rarely be necessary, while without annual amortisation a possible impairment might be indicated more often. We are aware that the above is in contrast to the concepts followed in full IFRS but we believe that our proposed concept is acceptable for SMEs.
- The pension accounting requirements in the staff draft version of an ED-IFRS for SMEs suggests the reduction of options with regard to actuarial gains and losses stemming from the defined benefit liability. This approach does not seem to reflect the IASB’s overall approach to include all options available in full IFRS within the IFRS for SMEs as well.
- Moreover, less **disclosure requirements** could enhance the applicability and by improving the cost-benefit-ratio increase the acceptance of the IFRS for SMEs. The vast number of required disclosures was one of the starting points for this project. This could be achieved by either eliminating disclosure requirements or by reducing the level of detail. In addition some disclosures may violate contractual confidential-

ity obligations. Examples for such disclosures and disclosures that could be eliminated or required in less detail are listed in the enclosed appendix.

However, we do acknowledge that eliminating disclosure requirements will prove difficult as each disclosure can serve a particular information need. The difficulty will be to evaluate whether the costs of generating and disclosing the information are higher or lower than the value the disclosure creates for the external user. Therefore we would suggest considering to include additional comments with regard to a materiality threshold for disclosures. These could be a qualitative statement confirming the importance of the materiality principle for disclosures.

From our understanding users of financial statements of SMEs (especially banks) share our point of view. While in principle they are interested in detailed information and the application of transparent accounting provisions, they still acknowledge that SMEs cannot be required to provide as many information as for instance companies applying full IFRS and some information resulting from burdensome accounting provisions could be waived for SMEs.

Finally, we would like to emphasize again that the acceptance of the IFRS for SMEs in Germany will greatly depend upon the issue of classification of equity and liability. The staff draft of the ED-IFRS for SMEs addresses accounting for the issue of equity instruments to individuals or other parties acting in their capacity as investors in equity instruments. However, there is no apparent solution for the issues we have explained to you with regard to IAS 32 that affect certain legal forms in Germany – most of them likely to be SMEs. In order to promote this standard it will be necessary to ensure that the IASB is taking care of this particular issue, otherwise SMEs will certainly reject the IFRS for SMEs altogether.

If you would like further clarification of the issues addressed in this letter, please do not hesitate to contact me.

Kind Regards

Prof. Dr. Harald Wiedmann

Par	Requirement in Staff Draft: ED-IFRS for SMEs	Remarks by GASB
8.8	If an entity is subject to externally imposed capital requirements, it shall disclose the nature of those requirements and how they are managed, including whether the requirements have been compiled with.	This requirement could be eliminated. It appears sufficient to only disclose the existence of externally imposed capital requirements.
11.46	pledged financial assets as collateral for liabilities or contingent liabilities, it shall disclose: (a) the carrying amount of the financial assets pledged as collateral; and (b) the terms and conditions relating to its pledge.	From a cost/benefit point of view this disclosure could be reduced to (a). SMEs could be released from the requirement to describe terms and conditions relating to its pledge.
11.47	For loans payable recognised at the reporting date, an entity shall disclose: (a) details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable; (b) the carrying amount of the loans payable in default at the reporting date; and (c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.	While these are important information, SMEs should be allowed to give less detailed information. It seems appropriate to disclose (a) and (b), but maybe less detailed information could be sufficient. E.g. only disclosing the fact (default) and the carrying amount of the loans payable. Moreover, if an entity has already come to terms about a loan payable (e.g. by renegotiation), the entity should not have to disclose any of these information as the quality of the loan arrangement has changed.
12.20g)	An entity shall disclose the carrying amount of inventories pledged as security for liabilities.	It should be clarified that this does not include the disclosure of the carrying amount of each inventory position, but only a total amount of inventories pledged as security for liabilities.
13.5 and 13.8	If the equity method is used to measure an investment in associates: The investor shall also make the disclosures required by IAS 28. However 13.8 already explicitly requires disclosures for investments in associates accounted for by the equity method (share of the profit or loss of such associates, the carrying	It appears sufficient to have disclosure requirements in the SME standard as addressed in par. 13.8. Additional disclosures (of IAS 28) do not seem necessary.

	amount, and its share of any discontinued operations of such associates).	
13.8	For investments in associates accounted for by the equity method, an investor shall disclose separately [...] its share of any discontinued operations of such associates.	The last clause should be eliminated as it is overly burdensome for SMEs to obtain this information, particularly if the investee is a non-public entity that does not report under IFRS.
18.23d)	...the acquirer shall disclose the following: (d) the cost of the combination and a description of the components of that cost, including any costs directly attributable to the combination.	Due to fewer transactions disclosures tend to be less aggregated than in larger entities. Therefore the degree of detail is relatively higher, which is not adequate for SMEs. It should be considered to exempt entities from this disclosure if it would violate contractual confidentiality obligations.
18.25	For each business combination effected after the end of the reporting period but before the financial statements are authorised for issue: same as 18.24.	The disclosure requirement should only include a disclosure about the fact that such business combination was carried out.
27.38	An entity shall disclose the total cost of defined contribution plans for the period and their amounts (a) recognised in profit or loss as an expense <u>and (b) included in the cost of an asset.</u>	This paragraph exceeds IAS 19.49, which does not seem adequate for SMEs. It appears sufficient if SMEs disclose the amount recognised as an expense for defined contribution plans. Moreover, the benefit of this disclosure with regard to the capitalized amount seems questionable.
27.39 (a)	... a general description of the type of plan, <u>including funding policy</u>	This paragraph exceeds IAS 19.120A (b), which does not seem adequate for SMEs.
27.40 / 27.41	For each category of other long-term benefits .... / For each category of termination benefits that	Eliminate this requirement as IAS 19.131 / IAS 19.141 et seq. do not require additional information about other long-term benefits / about termination benefits.