Deutsches Rechnungslegungs Standards
German Accounting Standards Committee e. V. ®

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Questionnaire on Possible Recognition and Measurement Modifications for Small and Medium-sizes Entities (SMEs)

Dear Mr Pacter

The German Accounting Standards Board (GASB) welcomes the opportunity to comment on the issues addressed in the Questionnaire on Possible Recognition and Measurement Modifications for Small and Medium-sized Entities (SMEs).

General remarks

We would first like to explain the scope of entities GASB is considering. We generally agree with the qualitative criteria for SMEs tentatively defined by the IASB. As laid out in our comments on the Preliminary Views GASB sees it as a task of the national legislators to mandate the use of full IFRS.

Still for identification of possible modifications for SMEs in Germany a more precise characteristic of SMEs might be necessary. Entities qualifying for application of standards for SMEs should be non-publicly accountable as defined by the IASB but in addition should have external users and prepare general purpose financial statements. These entities should also meet a quantitative criterion. We concluded that entities with an approximate yearly turnover of 50 Mio. € best represent the typical German “Mittelstand” entity which might have to apply standards for SMEs. As mentioned before this is only a threshold to guide discussions since the final scope will have to be regulated by national legislators.

Our views expressed herein are based on considerations of users’ as well as preparers’ needs whereby cost-benefit-aspects play an important role. SME standards should ensure consistent accounting treatments and a balance between users’ and preparers’ needs. Main users of SME financial statements are shareholders and creditors such as banks. Even though some of them do not need to only rely on information provided in external financial statements their needs are essential for developing SME standards because access to other informational resources is not guaranteed.

GASB would again like to stress the importance of a stand-alone solution for standards for SMEs. SMEs should not be burdened with acquiring and keeping an in-depth knowledge of IFRS as required by the proposed “mandatory fallback” by including IFRSs at the top of the accounting policy hierarchy in the SME standards. This would amplify the amount of regulations that SMEs need to comply with for preparing financial statements with the result that SMEs have to consider even more literature in comparison to a publicly accountable entity using IFRSs. Therefore a “mandatory fallback” to IFRS should not be implemented.

At the same time the SME accounting rules should be as close as possible to IFRS standards so that a later change of a SME to full IFRS standards will not pose a cumbersome burden.

We believe it is essential to develop standards for SMEs which allow for comparability between SMEs. Therefore, in spite of acknowledging the diversity of SMEs, only options already available in the IFRS should be allowed for SMEs rather than admitting additional options. At the same time GASB abstained from deleting available options so that SMEs can choose from the same alternatives as users of full IFRS.

IFRS are subject to ongoing revision. Changes in IFRS will entail revision of SME standards. When an option within IFRS is withdrawn a review of SME standards is necessary to evaluate if and to which degree this option limited the comparability of SME financial statements. As a rule the option should also be deleted within SME standards since options typically reduce comparability. Exceptionally the option can be retained when it is crucial to SMEs.

Furthermore we would like to emphasize that we consider a topical approach more desirable (e.g. recognition, measurement, disposal etc.). This would be more effective, since standards in a logical user-friendly order can evolve over the time without implementing new standards on matters arising and this will ease finding guidance on issues to be solved by preparers. The number of standards can be reduced. An example would be integrating the treatment of borrowing costs into the measurement requirements rather than issuing a stand-alone document. In addition the adequate accounting treatment can be chosen for each issue instead of applying a single standard to all accounting issues. An example would be IFRS 5. While in principle a separate regulation of non-current assets held for sale and discontinued operations might not be necessary within standards for SMEs the concept of IFRS 5 can be appropriate in some cases.

When no market values from active markets are available, subsequent fair value measurement often requires complex and burdensome valuation efforts. Under cost/benefit considerations and the assumption that complex derivative transactions are generally not carried out by SMEs, the GASB is of the opinion that in principle SMEs should not have to apply extensive valuation techniques. It is also believed that only in rare circumstances alike or similar transactions are available for a reliable fair value measurement. Therefore only fair values available on active markets should be used. Otherwise measurement should be based on historical cost when active market values are not available. In addition SMEs should make use of easier value estimation methods. For example values of assets under IAS 16 should be estimated only by means of replacement costs.

Finishing the general remarks we would like to point out that on purpose the existing interdependency of tax and financial accounts under German law did not form part of our considerations although these might play a more important role for SMEs when compared to publicly accountable and in general larger entities. This is consistent with the objective of IFRS, which should not be impacted by such interdependencies. Overall we do not consider a linkage between financial and tax accounts an appropriate approach because quite often tax regulations have objectives other than those for financial reporting. We therefore suggest deleting this principle for national GAAP in general.

Following, please find our comments on question 1 on areas for possible simplifications of recognition and measurement principles for SMEs in numerical order.

IFRS 2

The requirements of this standard should be retained.

IFRS 3

SMEs should generally account for Business Combinations according to IFRS 3. As outlined in our general remarks modifications should be considered for fair values measurements where no fair market values from active markets are available.

GASB also considers it possible to allow for group measurement in case of assets being of similar nature and use to the entity. For example similar items of machinery recognised in a business combination could be accounted for as a group.

In general SMEs are not likely to acquire an entity which comprises diverse business activities. Therefore simplifications for allocating the goodwill would not be necessary. Nevertheless when the allocation of goodwill is necessary values determined following SME IFRS 3 could be incorporated on a proportional basis.

Under cost-benefits aspects we favour the amortisation of goodwill for SMEs, also in order to avoid a regular annual impairment test since such impairment tests are too complex and costly for SMEs. Accordingly, it is proposed that for SMEs an impairment test would just be required if relevant indicators command such an impairment test. Taking into account the proposed amortisation of goodwill it is realistic to believe that only in a few cases indicators might call for an impairment test on carrying amounts reduced over the time.

IFRS 5
SMEs should be exempted from applying IFRS 5. Non-current assets (or disposal groups) that the entity intends to sell should be measured in accordance with IAS 36 (see below).

IAS 11/ IAS 18
We do not believe that modifications of the poc-method and stage of completion accounting (IAS 18) respectively are necessary. The requirements in respect of these methods rather encourage the development and improvement of internal project controlling methods and should therefore be retained. Nevertheless it will be essential to modify presentation and disclosure requirements of IAS 11 in connection with the discussion of these issues later on in the SME project.

IAS 16
In principle the requirements of this standard should be retained.

However, modifications should be considered in respect of the component approach. SMEs should account for separate components only when a clear distinction and separate valuation are attainable.

To reduce costs SMEs should not have to review the residual value annually but only when changes are clearly indicated.

IAS 17
The requirements of this standard should be retained.

IAS 19
As outlined in our general remarks we believe that the complexity of accounting standards can be reduced by eliminating extensive measurement methods for the fair value determination (subsequent measurement). According to this approach plan assets should only be measured at fair value when active markets exist. Otherwise the measurement should be based on historical cost.

IAS 21
The requirements of this standard should be retained.

IAS 23
The requirements of this standard should be retained.

IAS 27/ IAS 28/ IAS 31
In the context of accounting for subsidiaries, jointly controlled entities and associates GASB recommends deleting the references to IFRS 5. While these requirements are

necessary to satisfy the information needs of users of financial statements prepared by large entities it would be overly burdensome for SMEs. We believe this information to be less relevant to users of SME financial statements.

It should be considered exempting SMEs from the overall requirement to include associates and joint ventures on the basis of uniform accounting policies. Only significant known differing accounting policies would need to be adapted. Optionally uniform accounting policies would be demanded only for material jointly controlled entities and associates.

IAS 36

In accordance with the comments made regarding IFRS 3 and the re-implementation of amortisation of goodwill for SMEs the GASB suggests deleting the distinction between finite and indefinite useful lives for intangible assets. SME standards should include the requirement to determine a useful life for each intangible asset which implies amortisation of all intangible assets. It is understood that on the one hand determining the useful lives requires best estimates but on the other hand it is expected that only in rare circumstances there will be intangibles where the assumption of indefinite useful lives could be supported by reliable evidence. In addition to this and consistent to our comment to IFRS 3 one major reasoning is also the fact that an annual impairment test for intangibles with an indefinite useful life would be too demanding and costly for SMEs. Accordingly an impairment test should only be required when relevant criteria indicate that an asset may be impaired.

In case an entity intents to sell an asset it would have to determine only the net selling price as the value in use no longer represents an appropriate measure. This approach incorporates part of the IFRS 5 concept. Opting for the topical approach GASB sees the opportunity to choose certain aspects more relevant to SMEs while avoiding the less relevant or more complicated parts.

IAS 38

As mentioned under IAS 36 the distinction between finite and indefinite useful lives of intangibles should be omitted. This would constitute an annual amortisation of all intangibles which seems to be the appropriate accounting treatment for SMEs.

IAS 39

Especially applying the complex requirements of IAS 39 could be difficult for SMEs.

GASB is of the opinion that in accordance with the approach to subsequent fair value measurement described above SMEs should refer only to active markets for measurement of financial instruments. Otherwise cost measurement should be applied.

As far as the effective interest method under IAS 39 is concerned GASB suggests retaining the requirement for SMEs as well. We do not see severe difficulties in applying this method.

Furthermore GASB recommends modifying the requirements regarding hedging and embedded derivatives for SMEs. However, specific proposals still need to be determined. Therefore we would like to postpone detailed comments on these issues until after the GASB meeting on 13 June 2005.

IAS 40
The requirements of this standard should be retained.

IAS 41
In principle this standards should be retained. However, only fair values available on acitve markets should be used. Measurement should be based on historical cost when active market values are not available.

To conclude our comments we would like to state that overall the SME project has evolved rather fast. This made it impossible to include every specific issue regarding recognition and measurement modifications for SMEs. Also at this stage of the project many aspects could not be discussed as detailed as the matter might require. Therefore GASB would like to reserve the right to bring in additional comments at a later point in time which may include further facets of recognition and measurement issues.

If you would like any clarification of these comments please contact me.

Yours sincerely,

Prof. Dr. Klaus Pohle
President