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FINANCIAL REPORTING ENFORCEMENT PANEL

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Reducing Complexity of IFRS

Dear Melanie:

As you may be aware, we have already expressed in a letter to your chairman our appreciation for the initiative of the Financial Reporting Council regarding reducing complexity in accounting.
We would like to give our view on the eleven questions you have raised together with some remarks, as follows:

Response to Question1:
We also regard principles for less complex regulation as a means of reducing complexity. Of course, such principles will not be able to eliminate all complexities.
The crucial question is the differentiation between principles-based and principles-only regulation. One aspect which might be worth considering is to what extent regulations should be enforceable. (The study of The Institute of Chartered Accountants of Scotland –"Principles-Based or Rules –Based Accounting Standards? of 2006 discusses this issue in depth.)

Response to Question 2:
We would not see cash flow reporting as a first priority, but undoubtedly some improvement would be helpful. It is very interesting to consider whether change only can be brought about by a change of IFRS or by other more indirect means. Here it may be necessary, depending on the culture of a country, to take into account the impact of, for example, a best practice guide.

Response to Question 3:
We do not believe that accounting standards and other regulations should be based more on the information that management produces internally. Such a requirement would simply result in a fair amount of companies misusing such an opportunity. At least in the German environment, a discussion, for example, about the "spirit" of a standard often leads to the remark: "show me the standard which specifically does not allow me to do what I have done." Companies' management are not interested in the "spirit" of the standard when they have their own a separate agenda.

Response to Question 4:
Stemming the constant growth of accounting disclosure requirements is, in our view, one of the areas where change is absolutely needed. The bulk of information the standards require is simply too much. It may be worth reflecting where this disclosure-overkill originated. Representatives of the IASB often argue that analysts request certain information without specifying who these analysts are. This subject was recently broached in a public discussion when an IASB Board member explained that a standard needed to be modified due to analysts' requests. The CFO of SAP, who contacts analysts around the world weekly, stated: "You then must talk to completely different people; your argument never came up in my discussions." Sometimes you hear that the huge American Institute of Analysts has a dominating influence when presenting their views due to their extensive membership. A project like the one you propose may help to give other views more voice.

Response to Questions 5 and 6:
In Germany, the view prevails that financial reporting must satisfy the needs of the stakeholders, including for example employees and creditors. Any discussion about reducing the scope of public information required in Germany has very little chance of success, even if a 100% parent company provides adequate guarantees to its subsidiary. We would consider such discussions about reducing the requirement for filing audited accounts with full disclosures to be fruitless. As the main purpose of your initiative is reducing the complexity of IFRS, a discussion on the scope of financial reporting for wholly-owned subsidiaries could make the initiative less focussed.

Response to Question 7:
You raise the question in a general manner relating to whether complexity would increase if national and international regulators worked together in a more joined-up way. Our main concern is the complexity of IFRS. We do not see a risk of "importing" additional complexity due to international regulators.

Response to Question 8:
Yes, a clearer and more understandable way of formulating the standards would reduce complexity. Examples of unclear standards are numerous. The principles you propose could be helpful. How to go about implementing these principles is the key. One way could be to collect examples of unclear paragraphs or expressions, discuss these with the IASB and afterwards develop more detailed guidance for formulating the standards.

Response to Questions 9 and 10:
Definitely yes; your principles, if applied, would substantially improve the understandibility of financial reporting and, thus, reduce its complexity. Since clarity can hardly be forced by regulation, other means like best practice guidance would have to be considered. But one has to be realistic. Management sometimes has no personal interest in clear language.

Response to Question 11:
We recommend further action for:
--Acquisition accounting
--Capitalisation of R&D
--Defined benefits pensions
--Discontinued operations
--Fair value
--Financial instruments: general
--Share-based payments

In Germany the "Institut der Wirtschaftsprüfer" (IdW) seems us best placed to assist in any action. (We have not contacted the IdW if it would agree to do so.)

As a next step it may be worth considering to get the commitment of the IASB to support and get involved in a clearly defined project for reducing complexity in financial reporting.

We hope you find our remarks helpful and we are looking forward discussing the issues with you in more depth.

Best wishes

Axel Berger

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