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Bulletin on COMPLEXITY – personal comments

Dear Mme Flores, dear Ladies and Gentlemen,

I welcome the chance to present my views on some aspects of the Bulletin, in particular to the following questions being raised at its end:

- (i) Do I think there should be explicit discussion of the different aspects of complexity in the Conceptual Framework?

Yes, I think there should while considering the following aspects:

1) It should be made explicitly clear, that IFRS are principle based and as such will not present and address any potential circumstance and also not any given or potential complexity. The framework is to be used as a basis for interpreting any specific condition and complexity not addressed in the standard thus leaving room for adequate solutions in the given situation and topic.

If in turn the standards try to address too much detail and thus become rather rule based the complexity will increase by nature (as is demonstrated below as a consequence of the benchmarking).

2) It might be helpful to include a specific section in the framework dealing w/ complex transactions/ business issues addressing the following:

-> any transactions/business issues will get a specific qualification of implied complexity (perhaps grades from 1-5)

-> in case of grades of 3 or 4 and higher there are generally additional specific requirements for the standard setter and/or IFRIC, the preparer and the auditor.

3) It should then be made clear, which responsibilities the following parties have in regard to complex transactions:

The standard setter must discuss and determine the relevant complexity level for any standard/issue (see below). Depending on the specific complexity level, a standard must include additional explanations how to deal with it. May be in case of higher complexities a specific phrase must be included in the notes as to how the preparer has dealt with individual high level complexities.

The preparer may be in charge of specific documentation, that he has adequately dealt with the given level of complexity and how.

The auditor will give his opinion on the preparer's dcoumentation.

(ii) Are there any aspects of complexity in accounting not covered by this Bulletin that should be covererd?

Yes, I think the follwoing aspect not covered should be adressed:

This the influence of the Big4 audit firms in regard to the interpretation of standards and the remaining choices in regard to its application.

IFRS used to be principle based accounting standards with the consequence that the individual circumstances and transactions were not specifically addressed in the standard. Additional interpretations were giving further advice as to the application, while leaving it to the preparer and the auditor each how individual companies in individual businesses may apply the standard in individual instances under the given circumstances.

Development in the past 10-15 years

While there were a number of rounds of far reaching revisions and improvements concerning the first IAS/IFRS, preparers and auditors had to cope with the constant changes and usually increasing extent of details and disclosure requirements each resulting in increasing complexity.

Preparers developed accounting manuals for internal use by its global business entities and its employees thus assuring comparability in application and interpretation. However still leaving the final decision to the local entity of the preparer.

In regard to the large audit firms however an ongoing trend could be seen not to leave too much of flexibility to the local units. This trend became dramatically pushed ahead with the Enron scandal in the US and the establishment of the PCOAB.

Based on very restrictive documentation and control requirements by the SEC (SOX) the auditors of a parent company with a US listing got far reaching responsibilities as to as-

asuring, that local auditors performed their work adequately. For that purpose internal accounting manuals were prepared and used within the Big4, which became more and more specific and detailed. Besides brochures were prepared to specific accounting topics or illustrative financial statements and offered for external use (i.e. clients and the general public).

With the years the manuals (KPMG, Arthur Andersen/E&Y, PWC) were increasingly offered to the audit clients to be used by them as well - with two effects. The high level of knowledge and experience of the big audit firms were used to support the clients in preparing the accounts and reports on the one hand. On the other the audit requirements were already integrated. Thus a comparability not only within an international audit team was assured but it allowed also the assurance of a global quality level and as such reducing the risk exposure especially of US domiciled audit firms, where the auditors liability is very far reaching.

Once IFRS became accepted for US listings as well and since the start of the convergence process moving IFRS and US GAAP closer to eachother these US circumstances and customs became rolled out internationally within any of the Big4 audit firms thus covering any audit also of clients listed outside of the US.

While the audit manuals became increasingly extensive the next step is since few years that they became offered to the general public as well. Did the first publicly available commentaries by PWC "Understanding IFRS" had some hundred pages, the 2011 set of 4 books of its "Manual of accounting" incl. illustrative IFRS corporate consolidated financial statements contained +/- 5.000 pages. It is presented as "a practical guide to ... (IFRS) providing comprehensive guidance ... It "contains straightforward explanations on how to prepare financial statements in accordance with IFRS being "full of insights based on PwC's IFRS experience around the world". While this manual was named a "practical guide" its 2014 successor is supposed to illustrate "how even the most complex calculations and disclosures should be made".

The comparable product by Ernst & Young ("International GAAP 201x . Generally accepted accounting practice under International Financial Reporting Standards") is targeting to help to achieve consistent application of the IFRS while generally claiming for a single set of global standards and thus for continuing efforts to converge IFRS with US GAAP.

Besides the manuals the number and content of brochures and newsletters became more and more extensive and detailed as well. In regard to a new leasing standard (which cur-

rently exists only as an exposure draft) dozens if not hundreds of studies, brochures and webcasts by the Big 4 are already available incl. numerous ongoing publications ("point of view . . .", "Issues and solutions . . .", "data line ..." "topic summaries . . .", "leases newsletter . . .", "insights ...). Taking this example it is clearly visible, that the guidance gets more and more industry and topic specific on the one hand (leases in: telecommunication industry, retail business, rental car industry,) and proactive on the other.

Judgement

This development demonstrates that the question how existing or new standards may be applied by preparers became more and more dominantly influenced and defined by the 4 large audit firms. While working out and presenting as much details as possible and as early as possible the Big 4 firms were and are setting benchmarks not only for their own clients but to nearly any remaining applicant and constituent. And it appears that these benchmarks are usually set at a rather high complexity level as they are to cover any potentially relevant circumstance in any jurisdiction and as thus move more and more closer to rule based accounting structures (thus in direction to the "cook book" accounting environment in the US).

As the knowledge and personnel capacities of the Big4 companies can today not be matched by any other organisation or institution the brochures and commentaries by the Big4 prepared and published in the earliest stages of discussions and the due process of new standards, there are usually no discussions concerning alternative ways of applying it. This the more, as nearly any ambitious student intends to work with a Big4 company as the vast majority of professionals working on the preparers side have a Big4 background.

The same applies to the enforcement institutions as well as the people working with standard setting organizations.

Thus as of today it is increasingly difficult if not impossible to consider deviating solutions based on potentially specific circumstances and the own judgement and understanding of a non-Big 4 audit client and / or a non-Big 4 auditor.

Remains the question, which negative aspects are to be seen in this dominating benchmarking by the Big4 as it supposedly guarantees a high quality level of published f/s globally.

Having applied IAS, IFRS and US GAAP as a preparer for around 3 decades in the US as mostly in Central Europe it appears undoubtedly to me, that the application of IFRS became increasingly difficult with an (not surprisingly) obvious trend towards US conditions. This statement does not only apply to new standards and issues getting worked out more thoroughly. It clearly applies also to standard transactions having not changed in itself. It is rather a consequence of being opposed to audit requirements getting more and more restrictive every year, while the auditors any time are using the argument that no deviation from internal requirements is possible. However these requirements are typically set by centralized departments and individuals having no insights and experiences in local circumstances.

In practice that means, that neither the local individual nor the local auditor have a chance to deviate from the benchmarks although the actual circumstances might require it. This as well applies to materiality concerns – experience shows that more simple and pragmatic approaches tend to be less and less accepted by Big4 auditors notwithstanding, that cost/benefit relations might get clearly out of range.

This development is accompanied by Big 4 audit personnel working more and more in specialised areas only (in which they are trained also proactively). With the consequence, that the auditors often have a much higher degree of individual knowledge than the personnel of the preparer which have to cover a much wider area of accounting topics.

At the end and this is the situation as of today, the application of IFRS became a field which also companies of larger sizes can not manage with their own personnel anymore. In complex areas like acquisitions or financial instruments the preparers need the support of other Big4 companies (what is today normal in the banking industry for instance).

Another consequence is, that more and more non Big4 auditors lose their listed clients and that the accounting and audit requirements become an important cost issue and keep smaller companies from getting listed.

Proposal

It must become visible again, that Big4 benchmarks are only internal benchmarks and must not be followed necessarily by the applicant, also by a client. In a principle based accounting environment it must be (made) clear, that the local conditions (legal, tax, business, social law) are deciding about the right solution (for instance about constructive obligations or economic substances of a transaction ...).

Martin Zabel

page 6 - comment on Complexity bulletin 30. April 2014

One way of achieving a higher degree of flexibility and options where it is suitable could be to establish an independent institution in the EU with the task to develop detailed interpretation guidance to the application of existing and new standards with a higher complexity degree, which could be used by applicants and enforcement institutions. For a start this institution could take existing interpretations and manuals and extract the details considered necessary while keeping it at the minimum complexity level.

With kind regards

Martin Zabel

