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From: Huetten, Christoph [mailto:christoph.huetten@sap.

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To: Director - FASB

Subject: File Reference No. 1235-001.

Letter of Comment No: File Reference: 1235-001

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Dear Sirs

In response to your invitation to comment on 'Selected Issues Relating to Assets and Liabilities with Uncertainties' please find attached a comment letter that we sent to the IASB regarding the ED of proposed amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

Regards Christoph Hütten

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SAP's comment on the ED of proposed amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Dear Mr. Rees, Ladies and Gentlemen:

SAP welcomes the opportunity to comment on the ED of proposed amendments to IAS 37: Provision, Contingent Liabilities and Contingent Assets.

We appreciate the efforts of the IASB to create accounting standards that are of high quality with regard to providing useful information to investors and other readers of financial statements. We strongly believe that to optimize such usefulness, IFRS need to be applied globally, be it directly or via convergence with other internationally accepted standards. We are therefore of the opinion that convergence with US GAAP is highest of significance for any proposed changes to the presentation, recognition and measurement in financial statements. Identical or similar requirements by the IASB and the FASB are crucial not only for European US-listed companies but also for the aim to achieve world-wide comparability of financial reporting.

We appreciate the Board's intention to create principle based high quality accounting rules and to align definitions of the IAS Framework and the standards. Even though the proposed changes to IAS 37 are a result of the convergence project, many proposed changes create additional significant differences. Therefore SAP does not agree with all of the proposed changes to IAS 37 in ED IAS 37.



We outline below our responses to some of the questions raised by the IASB in the invitation to comment.

Question 2: Contingent liabilities

While we can follow the concept of breaking down a contingent liability into two obligations, we do not believe that this concept would improve the usefulness, particularly relevance and reliability of the resulting balance sheet and P&L data. The reasons for this are

- The lacking appropriateness of the probability criterion for single liabilities (see comments under question 5) and
- Significant measurement problems especially for essentially uncertain events (see comments under question 6).

As a result we do not agree that liabilities that are dependent on one or more future events should be recognised regardless of the probability that the uncertain future event will occur.

Question 4: Constructive obligation

We agree with the amended definition. This will reduce the timing differences of recognizing such obligations under IFRS and US GAAP.

Question 5: Probability recognition criterion

The IASB proposes to recognize all unconditional obligations unless they cannot be measured reliably. ED-IAS 37.23 states that the "liability arising from the unconditional obligation is recognised independently of the probability that the uncertain future even(s) will occur (or fail to occur)". Moreover the IASB assumes that "except in extremely rare cases, an entity will be able to determine a reliable measure of liability" (ED-IAS 37.27).

In contrast to this IASB assumption we do not believe that a lacking ability to reliably measure a liability is limited to extremely rare cases. Also, since the IASB decided not to change any provisions of IAS 38 it creates an antagonism between the treatment of contingent assets and contingent liabilities. Under the current amendments contingent assets will only be recognized if it is probable that the expected future economic benefits that are attributable to the asset will



flow to the entity; and the cost can be measured reliably (IAS 38.21) while the IASB expects that contingent liabilities can be measured reliably except for extremely rare cases.

We believe that in numerous instances it is indeed very difficult to measure reliably the outcome and probability of an event or transaction, particularly when evaluating events or scenarios that a company regards as highly unlikely. Companies will have to provide significant resources to determine estimated cash flow scenarios and related probabilities for highly unlikely transactions or obligations. Incorrect estimates will increase the volatility of earnings. Furthermore, the volatility of earnings will increase simply by removing the probability recognition criterion. In its presentation 'Non-financial liabilities amendments to IAS 37' presented at the World Standard Setters Meeting in September the IASB concludes that the accounting under the existing IAS 37 for a single product warranty is not appropriate if compared to a portfolio of product warranties. In contrast, SAP believes that the current rules are preferable to the proposed changes. In case of a single warranty or a single law suit with a low probability of economic outflows companies would under the proposed rules have to record a liability in year 1 and most likely reverse it in following periods when the outflow of economic benefits from the entity will - as initially expected not occur. Management would need to recognize liabilities and reduce income accordingly while at the same time admitting that it sees a very high probability that in the foreseeable future it will derecognize this liability and as a result increase income accordingly. We do not believe that such recording of liabilities provides relevant and meaningful information to readers of financial statements.

Under the current accounting rule companies would have to provide disclosures on contingent liabilities and would not post a liability until an outflow of economic benefits is probable. The current recognition rules would result in less volatility and in our opinion more useful information due to the required disclosures. The current rules are based on the proven distinction of items that must be treated on a single basis and items that have to be measured on a portfolio basis. The proposed amendment of IAS 37 leads to an unspecified mixture of those two types of liabilities.

The current probability recognition criterion is similar under US GAAP. The FASB has introduced the "stand-ready obligation" concept for guarantees only. We believe that an introduction of this concept for all contingent liabilities is not helpful due to the above mentioned reasons. As the FASB currently does not work on similar changes to its accounting rules for liabilities, the proposed



changes to IAS 37 would result in new significant differences between IFRS and US GAAP which are neither desirable for preparers nor for the readers of financial statements.

Preparers will have to invest in resources to value "liabilities" without substance, i.e. which will most likely never lead to an outflow of resources. Users of financial statements will have to eliminate those liabilities in order to assess the change in financial position that is helpful in assessing the future performance of the reporting entitiy. Therefore the topic of contingent liabilities is a genuine note item.

Question 6: Measurement

We agree with the board that an expected cash flow approach is an appropriate basis for measuring those obligations, that are probable and for which a company can come up with reliable cash flow forecasts. Due to the fact that the expected cash flow is a statistical measure, the quality and the decision usefulness of that value depends highly on its dispersion or variability. The more variable the expected values or the higher the range of expected values the more dispersed they will be. In cases where the statistical sample is very small or the range of the possible outcome is large, an expected cash flow amount might not always be the best estimate.

As a result we believe that the IASB should evaluate narrowing the interpretation of the current term "best estimate" and identify under what circumstances the expected cash flow is the best method to determine such best estimate. This is definitely the case with regard to obligations that belong to a large sample, which results in the applicability of the statistical law of large numbers and consequently allows the determination of highly meaningful and useful expected cash flow values.

However for two reasons we do not believe that the IASB should require an expected cash flow calculation for all type of obligations, particularly not for single obligations.

 In most cases it will not be a company's intention to transfer such single obligations to third parties. Therefore we believe that the price for such transfer is a measure less relevant to the readers of financial statements than the amount that the reporting company expects to pay.



The expected cash flow approach is based on known statistical methods that are derived from and made for portfolios of similar items. It is not appropriate to simply apply the same technique to single obligations.

Question 8: Onerous contracts

We agree with the suggested amendments. SAP has successfully implemented the US GAAP rules for onerous contracts including contracts for "unused lease space". We believe that the criteria and guidance under US GAAP have economic merit. Consequently similar rules under IFRS will improve financial statements using IFRS.

Question 9: Restructuring provisions

We believe that the amended restructuring provision rules can be implemented and provide enough guidance to determine when to recognize provisions. Essentially the established criteria for recognizing costs associated with restructurings in the ED-IAS 37represent a principle based convergence between US GAAP and IFRS which SAP appreciates.

We thank you for the opportunity to provide our comments to the suggested changes to IAS 37.

Sincerely,

Christoph Hütten
Head of Corporate Financial Reporting

Christiane Ohlgart IFRS Project Lead