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Comment of the Association of German Public Sector Banks, VÖB, respecting the IASB discussion paper "Management Commentary"

Dear Mr Teixeira

Thank you for the opportunity to comment on the discussion paper "Management Commentary", released by the International Accounting Standards Board (IASB) on 28 October 2005.

A. General remarks

In view of the increasing globalization of financial markets, we welcome and support your initiative to create globally uniform and high-quality standards for management commentary. Information regarding the business and operating environment and risk situation of an enterprise would facilitate decision-making on the part of current and potential investors and other interested parties and create a reliable basis for corporate reporting. A variety of national and international rules in concern of management commentary already exist, which vary in their scope and in their nature. Within the European Union, in addition to IFRS reporting, management commentary is governed by the Transparency Directive (2004/109/EC of the European Parliament and the Council dated 15 December 2004), which establishes management commentary from 2007 as a mandatory component of the financial reports of all issuers of publicly traded financial instruments in the EU. An IFRS standard could accordingly spell out the requirements of the Transparency Directive for management commentary and unify these Europe-wide.

However, the primary aim of a globally unified rule must be to avoid the multiple disclosure of the similar issues. This entails a level of regulation which must not fall short of national legislation. We consider it is appropriate essential that the new IASB standard orient itself on the most developed management commentary rules so as to enable it to supercede supranational and national regulations.

Please refer to our answers to the individual questions for specifics.

B. Answers to the questions

Question 1 – Do you agree that MC should be considered an integral part of financial reports? If not, why not?

We welcome the proposals to create a uniform, high-quality standard for management commentary. We consider management commentary as a reporting instrument to be an important, integral component of financial reporting. The information disclosed in the management commentary provides important insights for evaluating the risk and opportunity situation of an enterprise and promotes the comparability of companies, the decision-making of investors and ultimately the quality of competition in the financial markets.

Question 2 – Should the development of requirements for MC be a priority for the Board? If not, why not? If yes, should the IASB develop a standard or non-mandatory guidance or both?

We agree with the considerations of the project team and support an IASB standard for management commentary in the medium term. As no information medium equivalent to management commentary currently exists for IAS/IFRS users, German companies for example must supplement their IAS/IFRS financial statements with a management commentary to comply with the applicable provision of the German Commercial Code (Art. 315 Para. 2 HGB). The legal provisions are formulated in detail and expanded on in the German Accounting Standards GAS 5 and GAS 15, whereby these regulations do not cover all features of an IAS/IFRS financial statement. We assume that this also applies for other national provisions, and thus consider a uniform IFRS standard as inevitable in the medium term. We would welcome the soonest possible initial implementation with the possibility of a facultative earlier application.

If only recommendations and examples with little compulsory character are promulgated, corporations would retain broad scope in how they represent their business and operating environment. This would enable industry-specific information vital to understanding the management commentary to be presented and explained well. However, in this connection it must be ensured

that all corporations disclose a minimum amount of information, as otherwise the goal of uniform, high-quality reporting would potentially be undermined. Consequently, we recommend a procedure comparable to the existing German system, whereby a corresponding IFRS standard specifies the scope of reporting and is supplemented by appropriate industry-specific application guidance and examples for the presentation of details.

Question 3 – Should entities be required to include MC in their financial reports in order to assert compliance with IFRSs? Please explain why or why not.

As a consequence of the Transparency Directive of the European Union mentioned above, from 2007 on a management commentary will become a mandatory component of the annual report in addition to the financial statement for entities whose securities are approved for trading on any regulated market situated or operated in an EU member nation. Consequently, in order to achieve the goal of international harmonization of management reporting, all enterprises that use IAS/IFRS should be obligated to include management commentary in their financial reporting through a corresponding IAS/IFRS standard.

Question 4 – Do you agree with the objective suggested by the project team or, if not, how should it be changed? Is the focus on the needs of investors appropriate?

In principle, we agree with the proposed objective and are of the opinion that a high-quality management commentary should meet the information needs of investors and provide reliable, decision-relevant information. However, this should enable both investors and other interested parties to obtain an accurate impression of the business activities, business development, opportunities and risks of an enterprise. The further information requirements of other intended recipients of financial reporting should be met to at least this extent. However, it should be noted in this connection that reporting on issues such as the ecological sustainability of production or the social commitment of an enterprise should only be considered to the extent that these can exercise a significant influence on the asset, financial or earnings situation as well as the risk situation of an enterprise.

The discussion paper proposes as one objective of management commentary an evaluation of the corporate strategy and the probability of the success of this strategy by the management, which in our view also includes an estimation of the success of the risk management strategy. We consider such an evaluation on the part of management to be highly questionable and suggest omitting this altogether.

Question 5 – Do you agree with the principles and qualitative characteristics that the project team concluded are essential to apply in the preparation of MC? If not, what additional principles or characteristics are required, or which ones suggested by the project team would you change?

In principle, we consider that the principles formulated by the project team whereby the management commentary is to complement the financial statement and provide an analysis of the development of the enterprise from the point of view of its management and with a perspective toward the future to be appropriate.

We also agree with the qualitative requirements that the information of the management commentary be relevant for the understanding of the economic position of the enterprise, comprehensible and comparable. As to date the discussion paper has focused largely on fundamental requirements and lacks specific disclosure requirements regarding the object of the enterprise and enterprise strategy, we wish to refrain from commenting for now. However, the companies should be accorded the greatest possible scope for representing their business and operating environment and their opportunity and risk situation.

Question 6 – Do you agree with the essential content elements that the project team concluded that MC should cover? If not, what additional areas would you recommend or which ones suggested by the project team would you change?

In principle, we agree with the main content elements of a management commentary as set forth in item 100. With respect to the presentation of a management commentary from the point of view of management, we are of the opinion that the main contents should not be specified in too much detail. Rather, we consider the German approach of specifying the general standard by means of particular industry-specific standards as being more promising. For example, German Accounting Standard GAS 5, "Risk Reporting", is supplemented for the banking sector by GAS 5-10, "Risk Reporting by Financial Institutions and Financial Services Institutions". The effect of the German standards is to require a precise description of the risk management system of whole group and accountability with respect to its effectiveness. By contrast, the discussion paper contains no specific requirements for risk reporting either in general or with respect to specific circumstances. Requirements comparable to the German provisions should be imposed to avoid conflicts with national law and to ensure internationally comparable management commentaries in accordance with IFRS.

Furthermore, in addition to the report in retrospect, the management commentary should also contain a discussion of the outlook (DP A16). In particular, the commentary should explain whether past events, decisions and circumstances imply a particular future development (DP A17). Strategies and objec-

tives for the future should be described (DP A18 and A46). However, the intent is not to require quantification of future expectations. We consider with the proposal of the project team in this point and think a description of the future development would be adequate.

Question 7 – Do you think it is appropriate to provide guidance or requirements to limit the amount of information disclosed within MC, or at least ensure that the most important information is highlighted? If not, why not? If yes, how would you suggest this is best achieved?

We share the view stated in item 106 of the discussion paper that the management commentary should remain limited to the most important aspects. Negative and positive information of equal importance should be weighted comparably, so as to produce a balanced and reliable picture of the business and operating environment of the enterprise. In view of the existing size differences between the enterprises, we consider that restriction to a specific amount would not facilitate achievement of the objective.

Question 8 – Does your jurisdiction already have requirements for some entities to provide MC? If yes, are your local requirements consistent with the model the project team has set out? If they are not consistent, what are the major areas of conflict or difference? If you believe that any of these differences should be included in an IASB model for MC please explain why.

As already mentioned elsewhere, comparable requirements exist in the EU and in Germany. In the EU, companies issuing securities that are traded on a regulated market within the EU are obligated to provide management commentary as of 2007. The EU Modernization Directive (2003/51/EC) also contains management commentary requirements. Furthermore, comparable management commentary provisions have long been a part of national law.

In Germany, all corporations, and not just those entities that are listed, are obligated to prepare management commentaries (Art. 264 Para. 1 sen. 1 and Art. 290 Para. 1 HGB). The legal provisions specify the main content of the management commentary. This consists of the description of the business activity and the entities environment as well as the economic situation, the supplementary report, the risk report and the report of expected developments. Further industry related specifications are ruled in the German Accounting Standards mentioned above.

In Germany, Art. 315a HGB in conjunction with Art. 315 HGB additionally extends the obligation to prepare a management reporting to entities that prepare their financial reporting according to IAS/IFRS. It is thus urgently necessary that the IASB coordinate this project closely with the existing national and future European requirements for management commentary, so as to attain the goal of developing a standard that is accepted internationally and particularly in the EU. This is the only way to avoid possible inconsistencies with national regulations and unnecessary restatement costs on the part of enter-

prises already subject to management-commentary reporting while at the same time establishing a high-quality, internationally recognized standard.

Question 9 – Are the placement criteria suggested by the project team helpful and, if applied, are they likely to lead to more consistent and appropriate placement of information within financial reports? If not, what is a more appropriate model?

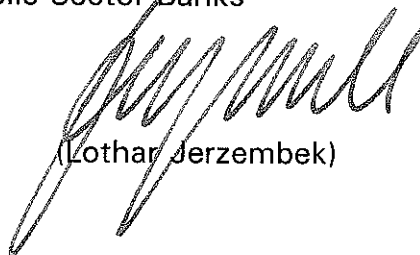
We are in agreement with the concept that the management commentary should complement the annual financial statement, establish the information stated in the balance sheet, the statement of profit and loss and the notes within the context of the enterprise and present the business and operating environment of the enterprise from the point of view of the management. In our opinion, the prospective character deserves special emphasis, in addition to the description of the reporting year under review from the point of view of management. The description of the opportunity and risk situation of the enterprise and the explanation of the risk management systems used for controlling represent important aspects that distinguish the management commentary from the annual financial statement. We thus believe it is necessary to formulate the objectives, principles and main contents in such a clearly delineated manner that such a distinction is possible even without explanatory examples. Otherwise, we recommend that the necessary examples be kept as general as possible but at the same time as precise as necessary.

If you have any further questions please don't hesitate and contact us.

Yours sincerely,
Association of German Public Sector Banks



(Karl-Heinz Boos)



(Lothar Jerzembek)