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Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street
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United Kingdom

Berlin, 10 March 2010

Dear David,

Exposure Draft ED/2009/6 Management Commentary

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the Exposure Draft ED/2009/6 Management Commentary (ED MC). We appreciate the opportunity to comment on this Exposure Draft.

We support the IASB's decision to view the management commentary (MC) as an integral part of financial reporting and to develop a document on this topic. We also concur with most of the requirements laid out in the principles-based document developed by the IASB. We are not convinced, however, that a non-mandatory guidance document published by the IASB is the most effective way to establish MC provisions that will be applicable worldwide. To our understanding, a standard on MC (IFRS for MC) could more effectively contribute to the harmonisation and improvement of financial reporting in an international environment.

We do not agree with the IASB's argument (ED MC.BC10) that only a guidance document would allow the individual jurisdictions to decide on the kind of entities mandated to apply the MC or on the level of assurance to which MC should be subjected. Instead, we would like to refer to the example of the IFRS for SMEs. This IASB document has the status of a standard but is not necessarily mandatory just because a jurisdiction requires the application of the other IFRSs. The IFRS for SMEs is only applicable if a jurisdiction explicitly makes that decision. This approach should be adopted for an IFRS for MC as well: its application should be independent

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of the application of the IFRSs for financial statements. Thus, the regulators or legislators could choose to require application of both the IFRSs for financial statements and the IFRS for MC, application of only one of the two, or none. Accordingly, compliance with IFRSs for financial statements and IFRS for MC would be determined separately.

Also, while the GASB supports a principles-based approach, which the IASB is proposing, we also see the need for further guidance on the content elements. In order for an IFRS for MC to be applicable by entities and to allow, within the limits set by the nature of the MC, for comparable MC of different entities, such a standard needs to provide a minimum level of application guidance. This is not fully provided in the ED MC.

In addition, we do not concur with your suggestion that the development of further guidance is best left to other organisations. Given the importance of the subject-matter the IASB should give this project the necessary attention and support and accept its responsibility for internationally applicable MC provisions. To our understanding this includes specifying the principles which are laid out in the ED MC rather than leaving the development of further application guidance to other organisations. The latter would inevitably result in "localised" MC requirements and therefore MCs not being comparable.

Please find our arguments and further comments on the questions raised in the invitation to comment in the appendix enclosed with this letter. If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

Appendix

Question 1 – guidance document

Do you agree with the Board's decision to develop a guidance document for the preparation and presentation of management commentary instead of an IFRS? If not, why?

The Discussion Paper Management Commentary (DP MC) proposed the development of a standard. In the light of the benefits of a standard the GASB supported this approach in its comment letter of April 2006.

Aligned with the IASB we believe that a MC is an important reporting instrument. It can significantly contribute to meeting the increasing demand of future oriented and value oriented information. MC can also contribute to aligning information provided for international capital markets and thereby making this information more decision-useful for the users. Therefore, we also support the IASB's notion of the MC being an integral part of financial reporting.

Considering the importance of a MC the international harmonisation of related requirements is essential. However, it seems that the possibilities of international MC requirements cannot be fully exploited when developing non-mandatory guidance on MC instead of a standard. Numerous existing voluntary frameworks have failed to harmonise and enhance MC information worldwide. Instead, in the absence of an international standard to refer to, national legislators, regulators, and standard setters have continued to develop and refine their local MC requirements.

The IASB lays out its arguments in favour of a guidance document (ED MC.BC10). It explains that certain decisions should be left to the individual jurisdictions. These decisions include whether the MC will be required in the financial report, the level of assurance, safe harbour provisions, or the type of entity that should prepare MC. We do not concur with the IASB's underlying assumption that these decisions could not be left to the jurisdictions if the IASB prepared a standard. We would like to refer to the example of the IFRS for SMEs. This IASB document has the status of a standard but is not necessarily mandatory just because a jurisdiction requires the application of the other IFRSs. The IFRS for SMEs is only applicable if a jurisdiction explicitly makes that decision. This approach should be adopted for an IFRS for MC as well: similar to the IFRS for SMEs the application of the IFRS for MC should be independent of the application of the IFRSs for financial statements. Thus, the regulators or legislators could choose to require application of both the IFRS for financial statements and the IFRS for MC, application of only one of the two, or none. Accordingly, compliance with IFRSs for financial statements on the one hand and with the IFRS for MC on the other hand would be separately determined. Entities not mandated by the legislator or regulator to prepare a MC can still claim to be in compliance with IFRSs for financial statements. If a MC is prepared the entities will separately declare compliance with all of the requirements of the IFRS on MC.

In our opinion only a standard provides a reliable basis for legislators, regulators, or standard setters worldwide intending to adopt internationally accepted requirements. There would be less need to continuously develop and refine local requirements. This could result in harmonised information requirements and therefore more decision useful information. Furthermore, the burden on entities could be reduced. For example, multiple filings due to multi-jurisdictional MC requirements could become obsolete.

Also, a standard would be a better ground for the IASB to discuss issues regarding the placement of information either in the notes and/or in MC. If both the financial statements and the MC are governed by requirements that equally have the status of a standard the currently open questions of placing information where they are most appropriate (see for example IFRS 7) are easier to decide on by the IASB. An IFRS could, for example, contain a paragraph clarifying the placement requirements for certain disclosures of this particular IFRS. Such a paragraph could be phrased as follows: “*Should the reporting entity prepare, in addition to IFRS financial statements, a Management Commentary (MC) under the IFRS on MC, the disclosure requirement listed above in para. xy can be provided in the MC rather than in the notes to the financial statements*.”

For the reasons listed above the GASB disagrees with the IASB’s proposal to develop a guidance document. Instead we prefer the publication of a standard. We would like to add, however, that even if the IASB decides to issue guidance only, close attention needs to be paid to avoiding conflicts with existing IFRS requirements as well as to avoiding the duplication of requirements.

Question 2 – content elements

Do you agree that the content elements described in paragraphs 24-39 are necessary for the preparation of a decision-useful management commentary? If not, how should those content elements be changed to provide decision-useful information to users of financial reports?

The GASB generally agrees with the principles-based approach proposed by the IASB. The ED MC lists the expected content elements (ED MC.24) and also provides more detailed guidance on what these content elements should specifically contain (ED MC.26 et seq.). We find this additional information necessary in order for entities worldwide to develop an idea of the kind of information expected in a MC. We especially appreciate that the ED is more explicit on the requirements regarding the orientation towards the future. Also, we find it helpful that risk reporting requirements are more detailed now and include other categories of risk besides financial risk (i.e. strategic, commercial, and operations risk) as well as information about "positive risks", i.e. opportunities.

One of the underlying principles is that MC information supplements and complements financial statement information (ED MC.13 (b)). MC includes additional explanations of amounts presented in the financial statements (ED MC.15). This is an essential part of MC. Nevertheless, there is no explicit link between MC and financial statements at the level of the content elements listed and described in ED MC.24 et seq. The IASB should clarify and explain for each content element how this information is supplementing and/or complementing the financial statements. For example, ED MC.24 lists "entity's most significant resources, risks and relationships" which could be connected to positions of the statement of financial position like intangible assets or obligations of the entity.

Despite this clarification regarding the link between the content elements and the financial statement positions, we suggest including more information about the kind of resources the management should report on. The IASB mentions that financial and non-financial resources should be discussed in MC. Nevertheless another distinction seems helpful in order to guide entities in reporting on resources: tangible versus intangible resources. Many intangible resources are not included in the financial statements, e.g. intellectual capital or research progress. Nonetheless information about these resources is essential for the understanding of an entity’s position and the MC could partially compensate for the shortfalls that the financial statements have with respect to providing useful information about intangible assets. We therefore suggest including an explicit explanation on the importance of reporting on intangible assets.

Regarding performance measures and indicators (ED MC.36) the IASB allows for both quantified measures and narrative evidence. However, the wording in sentence one (“…can help users of the financial reports assess ***the degree*** [emphasis added] to which goals and objectives are being achieved”) could be understood as if quantified information should be provided only. Therefore, the wording should be adjusted according to the intention of the IASB (ED MC.36).

A final remark relates to the management’s objectives and strategies for meeting those objectives which we believe to be essential for a meaningful MC. They allow evaluating management’s judgement about trends and markets and management’s decisions. Regarding the IASB’s proposal to discuss executive remunerations and its relationship to objectives, strategy and management action, these requirements should be brought in line with the information required under IAS 24. At least, it should be clarified, for example, how “executives” are defined and how this definition relates to “key management personnel” as defined in IAS 24.9.

Question 3 – application guidance and illustrative examples

Do you agree with the Board’s decision not to include detailed application guidance and illustrative examples in the final management commentary guidance document? If not, what specific guidance would you include and why?

The GASB supports the principles-based approach the IASB chose in developing the MC requirements. We believe that too detailed MC requirements would not reflect the specific character of MC information which substantially provides the management’s view for a particular entity. Therefore, MC requirements need to leave room for entity-specific information.

However, it is important that the reporting entities can develop a similar understanding of the requirements. As laid out above, the GASB proposes to develop a standard which – if mandated by local regulators and legislators – is to be applied in full by the entities. In order to be applicable by entities and to allow, within the limits set by the nature of the MC, for comparable MC of different entities such a standard needs to provide a minimum level of application guidance. By application guidance we mean guidance on the understanding and expectations as to the content elements. The application guidance should not necessarily extend to illustrative examples. In our opinion illustrative examples, such as those provided in the Discussion Paper MC, often bear the risk of motivating entities to simply mirror these examples irrespective of their entity-specific circumstances.

Thus, examples such as on page 40 of the Discussion Paper MC could result in “boilerplate language”. That example states the entity’s strategy for achieving the objective of being in the top quartile of the world’s property companies: e.g. “maximise the returns […]; focus on our customers with products that meet their needs; build and retain the best team in the property industry; and to focus on generating the maximum earnings from the capital invested […]”. We believe that this is well true for any entity, however it does not add much to the understanding of the information expected on “objectives and strategies” in MC. Application guidance on the other hand could clarify that the entity could discuss financial and non-financial objectives or the time frame for those objectives etc.

Furthermore, we do not find the IASB's reasoning with regard to application guidance and examples convincing. In question 2 and ED MC.BC48 the IASB states that it believes that the development of application guidance or illustrative examples "is best left to other organisations". To our understanding this undermines the objective of an international MC project: a self-contained, sufficient framework for MC reporting which allows for harmonisation of MC requirements worldwide. If "other organisations" were to develop the details for the framework provided by the IASB, national legislators, regulators, or standard setters would – as before – have to develop their own view regarding the details of MC requirements. This would most likely result in diverse guidance and examples. Therefore, in our view, any application guidance on MC should, similar to the guidance for IFRSs for financial statements, be developed by the IASB only.

Further aspects not specifically addressed in the invitation to comment

Qualitative characteristics

We support the approach taken by the IASB to view MC as an integral part of financial reporting which results in MC being within the scope of the IASB's framework. However, due to the specific features of MC it cannot meet all the qualitative characteristics defined in the current conceptual framework project (phase A, chapter 2).

This refers, for example, to forward-looking information and strategic information which is necessarily reported from the management's perspective and which is unavoidably of subjective nature. Consequently, specific information requirements such as comparability, reliability (faithful representation) and neutrality are challenged. Therefore, the GASB believes that the qualitative characteristics of the financial statements should be amended to clarify the differences in applicability to financial statements and the MC according to the future-oriented and subjective character of MC information. MC specific amendments should, however, be part of the one set of qualitative characteristics for financial reporting information to be provided in one comprehensive framework.

In ED MC.BC32 the IASB states that (within the framework project) it decided that it would be inconsistent to develop qualitative characteristics that are specific to MC. However, the paragraph goes on saying that questions about the applicability of the qualitative characteristics to MC should be resolved in Phase A of the conceptual framework project, not in the MC project. Irrespective of the project in which these questions are going to be resolved, the GASB recommends the IASB taking up the further discussion and evaluation of the qualitative characteristics in the light of the specific features of MC information.

Placement Criteria

ED MC.23 (b) states that the management of an entity should avoid duplicating in MC the disclosures made in the notes to its financial statements. However, the IASB (ED MC.BC45) also defers the discussion of placement criteria to Phase E of the conceptual framework project. It seems inconsistent to require “to avoid duplication” without providing the necessary guidance on how to achieve this objective.

The GASB believes the development of placement criteria to be a pressing issue which should not be delayed until Phase E of the conceptual framework is completed. We would prefer if upon issuance of a standard on MC the other IFRS were amended to allow alternative presentation in the MC of disclosures which better fit to a MC than to the notes to financial statements (please see our response to question 1 for how such amendments can be worded).

Segmentation

ED MC.23 (a) states that MC should be consistent with its related financial statements. Undoubtedly this is essential for the MC to provide decision useful information. However, the paragraph goes on saying that MC should reflect the segmentation which is included in the financial statements. Again, it is without doubt that – where necessary – MC information should reflect the segmentation in the financial statements. However, it could be helpful to clarify that this is only necessary to the extent that MC information differs across operating segments. A general requirement to segment MC information does not seem appropriate.

Requirement Exemptions

The MC document should allow for certain requirement exemptions. Similar to IAS 37.92 there can be rare cases in which the publication of specific information on the content elements of MC as described in the ED MC can be expected to prejudice seriously the position of the entity in a dispute with other parties or in the competitive environment in which the entity operates. Such information may concern details on the strategy or on forward looking information. For such rare cases requirement exemptions should be made, as long as the entity's legitimate interests need to be protected and the MC still provides a true and fair view of the entity's position.

For instance, in special circumstances in which there is an unusually high level of uncertainty surrounding the future development of the entity due to the macroeconomic environment, and the entity's ability to forecast is therefore materially impaired, there should be no requirement to disclose concrete information about the expected economic development of the entity. Nevertheless forward-looking statements may not be dispensed with in their entirety. If the forward-looking statements made are less concrete than normal because of such circumstances, the special circumstances and their effects on the entity's ability to forecast and on its results of operations, financial position and net assets shall be described. However, the information provided in MC has to contain at least all that information provided through other means of communication (e.g. analysts' conferences or the like).

Report on events after the reporting period

So far, the ED MC does not refer to disclosure requirements for significant events that occur after the reporting period. We suggest that such events and their expected impact on the results of operations, financial position and net assets of the reporting entity shall also be discussed in MC. This requirement would generally be in line with IAS 10 which asks for adjusting the financial statements and/or disclosures to reflect events after the reporting period. At the same time this example also reflects the issues emerging with regard to placement criteria (for information about events after the reporting period).