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28 April 2006

Mr Alan Teixeira
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International Accounting Standards Board
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Dear Mr. Teixeira

Discussion Paper Management Commentary

The Committee of European Banking Supervisors (CEBS) welcomes the opportunity to comment on the Discussion Paper Management Commentary (MC) prepared for the IASB by staff of its partner standard-setters and the Canadian Institute of Chartered Accountants and issued by the IASB for comments.

CEBS is comprised of high level representatives from the banking supervisory authorities and the central banks of the European Union. CEBS' role is to advise the European Commission, in particular as regards the preparation of draft implementing measures in the field of banking activities, to contribute to a consistent implementation of Community Directives and to the convergence of Member States' supervisory practices throughout the Community and to enhance supervisory co-operation, including the exchange of information.

Banking supervisory authorities and central banks have a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that would help strengthening market discipline.

The enclosed comments have been prepared by one of CEBS' expert groups, the Expert Group on Financial Information (EGFI), chaired by Mr. Arnoud Vossen, in charge of monitoring any developments in that area and of preparing positions to be taken by CEBS. The development of our comments on this Discussion paper was coordinated by a Subgroup of EGFI under the direction of Mr. Patrick Amis.

If you have any questions regarding our comments, please feel free to contact Mr. Arnoud Vossen (+31.20.524.3903) or Mr. Patrick Amis (+ 33.1.4292.6032).

Yours sincerely,

Danièle Nouy
Chair, Committee of European Banking Supervisors

Discussion Paper Management Commentary

General comments

As previously mentioned banking supervisory authorities and central banks have a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that help strengthening market discipline.

Market discipline constitutes a key aspect of our common supervisory framework and the Recast Directive 2000/12/EC (commonly referred to as the Capital Requirement Directive or CRD) contains several provisions on disclosure by financial institutions, the so-called 'Pillar 3 disclosure'.

As such, we regard MC as a key element of financial reporting, notably because it enables users to better understand the financial statements of an entity, in particular in the context of the environment in which it operates and also in the light of the prospects and objectives of its management.

MC is already compulsory in the European Union and we agree with many of the operational proposals mentioned in the discussion paper, which provides a very good analysis of the issues at stake. As a consequence we would have no major objection to the issuance of guidance on this basis.

However, we are of the opinion that there should not be a compulsory requirement to prepare MC in order to assert compliance with IFRS at this stage. In effect, by doing so, the IASB could be seen as trying to regulate in an area which in many EU countries is also governed by European and national legislation or regulations (e.g. on Corporate Governance, prudential regulation, company law…) and therefore covers numerous aspects that go beyond financial reporting. Therefore we believe that for some aspects (i.e. corporate governance) the competence for MC within the EU is shared with market regulators as well as European and national legislators.

Moreover, some of the conceptual proposals displayed in the document appear to be inconsistent with the current Framework: these include the definition of users of MC and the qualitative characteristics of MC. We believe that no decision in that respect should be made before a more comprehensive discussion has taken place between the IASB and its constituency, in the context of the ongoing revision of the Framework.

More detailed answers to the questions raised in the discussion paper are provided hereafter.

Detailed comments

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

From a banking supervisory perspective, we agree that MC should be considered an integral part of financial reports. Such requirement already exists in the European legislation, by virtue of the Directive 78/660/CEE for the annual accounts and the Directive 83/349/CEE for the consolidated accounts. We believe that MC disclosures improve the quality of financial reporting and are essential for readers to get an informed opinion on the financial position and prospects of the reporting entity.

We believe furthermore that MC can play a significant role in strengthening market discipline, which constitutes a key aspect of our common supervisory framework.

However, although part of financial reporting, MC is generally not a component of financial statements and as such is not submitted to a formal audit. Rather ISA 720 stipulates in paragraph 2 that the auditor should read the other information to identify material inconsistencies with the audited financial statements. It is important for users to be clearly aware of this difference (see also our answer to question 9).

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?

Issuing of an IFRS standard containing a requirement to prepare MC would fall out of the scope of the IASB's current Framework, which deals only with financial statements. For that reason, we suggest that no specific requirement should be made mandatory at this stage, and we see no urgency in the development of requirements under the form of a separate strand of standards aimed at MC, at least not before a more general discussion on the Framework has taken place. In any case, given the fact that MC is also related to corporate governance, we believe that the competence with regard to the definition of any kind of requirement in that respect is at least shared with market regulators as well as European and national legislators.

In that regard, non mandatory guidance could be regarded as a field testing exercise, allowing to revisit the subject if need be, with the experience of several years of implementation of the guidance. Such a gradual approach could also avoid any unnecessary implementation hurdles, in a period where IFRS preparers and users already have to implement and incorporate rapidly evolving IFRS.

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

For the reasons mentioned in our answers to questions 1 and 2, we believe that it would be premature to include a requirement to prepare MC in order to assert compliance with IFRS.

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

We agree with the objectives developed in the discussion paper. We understand that the third objective of assessment of the strategies adopted by the management encompasses future-oriented information, as developed in the "principles" section of the paper.

We agree also that the needs of investors do have to be taken into due consideration when setting standards. However, we believe that the focus on the sole needs of investors is not necessarily appropriate, as it narrows the definition of potential users of financial statements. The Framework currently identifies seven different users groups and their information needs that should be taken into account. As a consequence, we believe that any decision regarding the definition of users should be taken in conjunction with the ongoing work on the Conceptual Framework.

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?

We agree with the principles developed in the discussion paper. The orientation to the future is an important component of MC, as it provides users with a clear view of the objectives and prospects of the management. In that respect, the usefulness of future oriented information would be improved if management had to communicate a clear time horizon for the information provided.

Regarding the qualitative characteristics, we believe that it is essential to keep the discussion in line with the ongoing work on the Conceptual Framework. Any requirement or guidance dealing with MC should not include modifications of the qualitative characteristics before a more general discussion has taken place between the IASB and its constituency.

We attach particular importance to the concept of reliability, which is a key aspect of our supervisory approach when it comes to financial information and should therefore remain, in our opinion, a defining qualitative characteristic of the Framework. We noted that, in the current Framework, the concept of reliability includes both balance and supportability as defined in the discussion paper. Balance reflects the idea of “free from bias”, referred to as “neutrality” in the definition of reliability in the Framework. In the same way, supportability refers to “faithful representation” in the Framework.

Moreover, we suggest keeping the term comparability instead of comparability over time. The reason for this suggestion is that an explicit reference to comparability over time could be interpreted as excluding the possibility for a comparison between different entities, a development that we would not welcome. Although we believe that complete standardisation of MC would be inefficient and somewhat misleading, being disconnected from the operational management of the entity, we expect a certain degree of comparability between entities that are engaged in the same business, through the segmenting of their activities. Of course, this does not mean that we suggest that the information provided in MC should not be comparable over time. Comparability over time is an essential component of comparability and should apply specifically when the management provides information on a performance indicator that is not defined in an IFRS standard.

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?

We agree with the essential content elements developed in the discussion paper, although we do not regard the list provided in paragraph 100 as necessarily comprehensive: the disclosure of other information in MC could be regarded also as of particular importance, such as the explanation of certain events occurring after the balance sheet date, the presentation of key risk management policies and procedures or the disclosure of information in accordance with the “pillar 3” provisions of our supervisory framework (a large part of which could be placed in Management Commentary).

Besides, it is important to give the management the opportunity to adapt MC to the precise business, strategy and environment of the entity, in order to provide more relevant information to users.

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 believe that it is the responsibility of the management to select and explain the information they disclose in MC. However, we agree that entities should be encouraged to limit the amount of information provided or, at least, to highlight the most important issues. It is important also that the information should be provided in a balanced way, without putting too much emphasis on positive aspects.

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.

No comment. The existing European legislation is mentioned in the discussion paper.

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 found the idea of placement criteria interesting but we are sceptical about their implementation. We are not sure that it would be possible to establish clear and workable criteria in that respect. Besides, we understand that the simple implementation of the placement criteria suggested in the discussion paper would trigger significant modification of a number of IFRS standards, like IFRS 7 for example, with a significant impact on the level of quality assurance that is currently provided, in particular through the involvement of external auditors. We suggest that the IASB liaises with the IAASB on its work on MC and possible consequences this might have in order to allow the latter to address the issue that would likely arise with regard to the level of assurance.

We also noted a potential inconsistency with the exposure draft on segment reporting, which seems to include in the notes to primary financial statements information that the discussion paper would put in MC.

Finally, we are not sure that MC should necessarily be an alternative solution to disclosure in the financial statements. Disclosure requirements of IAS/IFRS standards should generally be included in the financial statements and not in MC, even though there might be situations where it could be useful for users that the same information is disclosed both in the notes and in MC (with the latter providing the views of the management).