

27 July 2012

Ms Stephenie Fox
IPSASB Technical Director
545 Fifth Avenue, 14th Floor
New York
NY 10017
USA

By email: stepheniefox@ipsasb.org

Institut der Wirtschaftsprüfer
in Deutschland e.V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0)211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0)211 / 454 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
BLZ 300 700 10
Kto.-Nr. 7480 213

Dear Ms. Fox,

Re.: Proposed International Public Sector Accounting Standard Financial Statement, Discussion and Analysis

We would like to thank you for the opportunity to provide the International Public Sector Accounting Standards Board (IPSASB) with our comments on the Proposed International Public Sector Accounting Standard: Financial Statement, Discussion and Analysis (hereinafter referred to as “the exposure draft”). We have included our responses to each of the Specific Matters for Comment (SMCs) in an appendix to this letter. We also submit our main comments as follows:

Support for a mandatory FSDA separate from the financial statements

In Germany there is a relatively long history in the private sector of reporting on an entity’s financial results, position and operating environment in a Lagebericht (Management Report) which complements, but does not form part of, an entity’s financial statements. Similar reporting (whether termed “Lagebericht” or “Rechenschaftsbericht”) is also prevalent in many cases in the public sector.

On the basis of experience in both the private sector and much of the public sector in Germany, the IDW believes that users’ information needs are well served by a combination of the information provided within a full set of financial statements and reporting provided in a management report pursuant to the

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB CPA;
Manfred Hamann, RA

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German Commercial Code [Handelsgesetzbuch (HGB)] and the German Accounting Standard No. 15 (GAS 15) “Management Reporting”. GAS 15, which is promulgated by the Accounting Standards Committee of Germany (Deutsches Rechnungslegungs Standards Committee e.V. (DRSC)), primarily provides an interpretation and further explanation of the legal requirements of the German Commercial Code. The Standards for Governmental Accrual Accounting in accordance with the German “Budget Principles Law” (Haushaltsgrundsätzegesetz (HGrG)) are also based on the requirements of the German Commercial Code, including in respect of the management report.

We therefore fully support the IPSASB’s decision to make preparation of financial statement discussion and analysis (FSDA) mandatory for public sector entities required to prepare general purpose financial statements. As noted in our responses to the SMCs, we also agree that the FSDA should not be a part of the financial statements, rather a separate report to complement the financial statements.

Subject to our response to SMC#4 in the appendix to this letter, we also support the principles-based approach taken in developing the exposure draft, which facilitates application of the Standard by all public sector entities presenting general purpose financial statements (GPFS) allowing sufficient flexibility to reflect a public sector entity’s individual circumstances.

Decision relevance of forward-looking information

The IDW has a serious concern regarding the IPSASB’s decision not to require the disclosure of forward-looking information such as forecasts or projections (BC17). For the reasons explained below, we support Mr Thomas Müller-Marqués Berger’s alternative view depicted on page 19 of the exposure draft.

We note that the IPSASB recognises that “information in the financial statements has predictive ability ... and that FSDA could enhance that ability” (second sentence of BC17). We are concerned that information as to risk management policies and trend analyses (but excluding forward-looking analyses) – which the IPSASB is proposing – will, on its own, not go far enough to providing a satisfactory basis to satisfy user needs. In our view, arguing that users in the public sector have different information needs related to the financial statements (BC2) does not constitute adequate justification for denying them access to further forward-looking information; information that is available to the entity itself.

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For decision-making purposes and, to a lesser extent, for accountability reasons financial statement users need to consider the potential an entity has to undertake future operations and fulfil its service obligations, irrespective of whether the entity is in the public or private sector. In the absence of additional reporting being made available to them, users are left to study solely an entity's financial statements and to use the information therein as a basis for making their own assumptions and predictions as to the entity's likely future operations and service potential, etc. Clearly, the more reliable such assumptions or predictions can be, the more useful they will be to those users. In our opinion, reducing the gap between the information available to users of the financial statements and that available to management (ref: GAS 15.3) as far as is reasonable ought therefore to be part of the objective.

Consequently, we would like to suggest that, in addition to information as to risk management policies and trend analyses as proposed, the entity should be required to provide additional information as to potential future developments (forward-looking information¹). We appreciate that by its very nature such information cannot be based on fact. However, it can be based on assumptions that in turn can be assessed as to their plausibility.

In regard to an entity's reporting in this area, we suggest a requirement not only for the entity to report on projected plans and expectations but also for it to discuss the future development in such a way that readers can relate this information to the reporting period. For example, FSDA could include a discussion or table of expected trends, explanation of principal influencing factors etc., such that it is clear that any figures provided do not purport to be exact predictions. We also refer to our response to SMC#4 in this context.

¹ Paragraphs 34 and 35 of GAS 15 specify: "The provision of forward-looking information also includes reporting on existing projections and management's expectations for the following two financial years. At a minimum, this shall consist of qualitative information, which shall be explained in the context of the material operating environment." and "The short-term and long-term views highlighted in the group management report shall be linked. The development of the business and the economic position of the group shall be explained in the context of expected developments, together with the material opportunities and risks associated with such developments".

GAS 15 is currently subject to revision. Among other things, it is proposed that rather than including forward looking information for a period spanning two years, such information should only cover one year from the balance sheet date.

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Requirement for FSDA to be audited or subject to an assurance engagement

We agree with the IPSASB that whilst the audit of FSDA is desirable, imposing an audit requirement on such information exceeds the Board's mandate (BC10).

In the private sector in Germany management reports are, by law, subject to independent assurance. Similar requirements also apply in much of the public sector.

Considerations about whether FSDA should be subject to any form of assurance engagement should take into account the level of assurance users would desire.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours truly,

Norbert Breker
Technical Director
Accounting and Auditing

Gillian G. Waldbauer
Technical Manager

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APPENDIX

Specific Matter for Comment 1:

Do you agree that the material presented in this Exposure Draft should be developed as an IPSAS, with the same level of authority as the accrual based IPSASs, which applies to all entities that prepare financial statements in accordance with IPSASs?

As noted in our accompanying letter, we agree that the same level of authority should apply as the accrual based IPSAS, such that all entities that prepare financial statements in accordance with these IPSASs shall prepare a FSDA to accompany the financial statements.

Specific Matter for Comment 2:

Do you agree that IPSAS 1 should be amended to clearly indicate that financial statement discussion and analysis is not a component of the financial statements?

We agree that this differentiation needs to be clear.

We further suggest that paragraph 11 refer not only to the need to distinguish the FSDA from the financial statements, but also from other information that may be published with the financial statements.

Specific Matter for Comment 3:

Is the scope of financial statement discussion and analysis clearly defined so as to distinguish it from other issues being addressed by the IPSASB (e.g., financial statements, service performance reporting, reporting on the long-term sustainability of public finances)?

Yes, the scope section distinguishes the FSDA reporting from other issues that are currently under consideration by the IPSASB. In our view, in order to be useful to readers, it is particularly important that FSDA reporting is not overly extensive. We therefore support the statement in BC13 that FSDA is required to “include significant items, transaction and events that are presented in an entity’s financial statements to the extent that it does not replicate information in the financial statements”.

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However, in regard to the proposed scope of the exposure draft we also refer to our main concerns addressed in the accompanying letter in respect of the IPSASB's decision not to require the inclusion of any forward looking information.

Paragraph 2 clarifies that the FSDA shall be prepared for the same reporting entity that prepares financial statements under the accrual basis of accounting. In our opinion, a similar clarification that the FSDA shall cover the same period as the financial statements whose issuance it shall accompany would also be helpful. Whilst paragraphs 6 and 7 do allude to this, firm clarification would be more appropriate.

Specific Matter for Comment 4:

Is the required content for financial statement discussion and analysis appropriate?

In regard to the proposed content of the exposure draft we also refer to our main concerns addressed in the accompanying letter in respect of the IPSASB's decision not to require the inclusion of any forward looking information.

We appreciate the IPSASB's desire to avoid a checklist approach in determining the content and format of presentation of FSDA (BC14). At the same time, we also consider it desirable for a higher degree of comparability to be sought both in an entity's reporting over time and between entities.

We have a number of comments in regard to the content in this context:

Level of authority attaching to significant material

The exposure draft is extremely short, given the scope of the report it is to relate to. In our view, the standard needs to be more detailed in certain areas, and non-authoritative implementation guidance should not be used to compensate for material that would be more appropriately placed in the final standard. We discuss certain such areas below.

Use of Subheadings

Including and in addition to the matters identified in paragraph 15, we would like to suggest that the IPSASB mandate the use of subheadings to order the narrative content. This would make the report easier to understand and enhance

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transparency for readers. It would also encourage comparability in such reports from year to year as well as between entities.

In addition to the matters identified in (a) – (d) of paragraph 15, we suggest that matters such as post balance sheet events (mentioned in paragraph 30 as “additional information”) and any significant so-called “one off factors” that may have occurred should also be considered for inclusion under their own headings to the extent that a public sector entity is affected. Where there are no such matters to be reported, no subheadings would be needed.

Application of qualitative characteristics

In our opinion, the section dealing with qualitative characteristics (comprising only paragraph 9) is not sufficiently detailed. We appreciate that the implementation guidance contains a more detailed discussion of the qualitative characteristics, but believe that this section would benefit from expansion within the body of the standard. For example, whilst IPSAS 1.27 stipulates that financial statements shall achieve fair presentation, we note that there is no equivalent requirement for FSDA to achieve fair presentation. In our view, as a minimum, such requirements need to be specified.

We also appreciate that further changes to this section in particular may be necessary once the IPSASB’s Conceptual Framework Project has been finalized.

Financial performance measures

The first sentence of paragraph 22 refers to the possible inclusion of performance measures that are not required or defined by IPSASs, but which may nevertheless be included in the FSDA. In addition to requiring such measures to be defined and explained, we would like to suggest including a requirement for them to be reconciled to items presented in the financial statements (without exception), since the information needs to be consistent with the financial statements.

Information about the entity’s risks and uncertainties

In our opinion, the content described under paragraph 15 (d) does not go far enough. In addition to risks and uncertainties there needs to be disclosure of opportunities. We realize that opportunities are mentioned briefly in paragraphs

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27 and 30, but believe there would be merit in making such information more prominent and transparent. In addition, the entity's strengths and weaknesses in relation to these opportunities and risks posed by the operating environment should also be disclosed.

Specific Matter for Comment 5:

Do you agree with the transitional provisions?

The IPSASB is currently considering first time adoption of IPSASs as an issue in its own right. We note that the Board has not yet finalized these deliberations.

We appreciate the fact that the Board does not wish to make it overly onerous for first time adopters to comply with IPSASs. In this context, and subject to completion of the Board's project on first time adoption of IPSASs, we agree with the proposed transitional provisions.

Specific Matter for Comment 6:

Is the Implementation Guidance useful to understanding the requirements of the proposed IPSAS?

In view of the fact that the implementation guidance is non-authoritative, as discussed in our response to SMC # 4 above, the section on qualitative characteristics would benefit from additional material being included within the final standard.

Specific Matter for Comment 7:

Is the Illustrative Example a useful way of illustrating the requirements of the proposed IPSAS?

We accept that an illustrative example is generally useful, as long as it is perceived as an example and not as best practice to which preparers feel the need to slavishly adhere.