ZENTRALER KREDITAUSSCHUSS

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Staff Draft of Exposure Draft IFRS X "Financial Statement Presentation" of 1 July 2010
ZKA-ref.: IASB

Dear Sir David,

We appreciate the opportunity to hereby submit our comments on the Staff Draft.

In our view, the proposed redesign of financial statement presentation constitutes a very important project with far reaching implications for preparers and users of financial information. We have been following the standard setters' topical debates on this pivotal project with keen interest. Whilst we basically welcome the Board's plans for a further harmonisation and enhancement of partly diverging financial reporting rules during the convergence process, any potentially required measures going beyond this which not only serve the harmonisation of existing rules but which also seek to achieve a fundamental redesign of financial reporting should be subject to a careful cost-benefit analysis.

In our view, there has not been any (material) change to the fundamental issues already criticised in our ZKA comments on the 2008 Exposure Draft (please cf. also our respective comments on the Discussion Paper).[1]

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[1] Cf. ZKA comments of 14 April 2009 available under:
http://www.zka-online.de/uploads/media/zka_diskussionspapier_finanzberichterstattung_1_.pdf.

At this juncture, one key issue is and remains the **direct method for the establishment of the cashflow statement** requested by the Board.

In this context, we would first of all like to point out that – neither under the direct nor under the indirect method – do banks' cash flow statements serve as a tool for liquidity management. The meaningfulness of cash flow statements is therefore extremely limited.

Cash flow statements are intended to provide readers of annual financial statements with information concerning the entity's capacity to generate cash and cash equivalents thus giving them an idea of an entity's future liquidity requirements. To this end, the cash flow statement provides information on the movements of cash and cash equivalents during the respective reporting period. This information is clustered (classified) into different groups based on operating activity, investing activity and financing activity.

The banks' role as financial intermediaries already makes obvious that - for the purposes of sharing liquidity information - cash flow statements can only provide limited information. Banks, in their capacity as financial intermediaries, have the task of bringing together parties seeking to raise capital and parties who wish to engage in lending activities. This way, borrowers gain access to capital and investors obtain investment opportunities. Yet, in addition to this, when it comes to said investment and financing transactions banks regularly also invest their own capital and/or capital which they themselves raised at the capital market. More often than not, a clear-cut disaggregation into operating activity, investing activity and financing activity that still makes sense to the reader of financial statements will result impracticable and counterproductive.

Whilst the liquidity situation in manufacturing companies is closely related to the production and sales situation, in the field of banking, such a correlation does not exist. Banks' liquidity management regularly takes place on day-to-day basis. This means that, usually, there will not be any unambiguous or permanent assignment [to any specific category, sub-category or section]. This is especially true when it comes to customer deposits. Based on the foregoing, it is not possible to assess a bank's liquidity requirements by referring to the cash flow statement. This is also confirmed by our experience that consequently, analysts and rating agencies do not pay any major attention to our banks' cash flow statements.

As far as the operating area is concerned, under the banks' present business practices, the current version of IAS 7 will usually inform the preparation and publication of the cash flow statement using the indirect method - notwithstanding the fact that the latter does not provide financial statement readers with any tangible information benefit (cf. our comments above). Use of the indirect method is mainly owed to the fact that it allows deriving the cash flows from the existing accounting data already available within the entity. Hence, with regard to data acquisition and data retrieval, compared to the use of the direct method, the indirect method ties up far less resources. Preparation of a cash flow statement by using the direct method would accordingly lead to considerable additional costs without adding in any way to the decision-usefulness of the information on a bank's liquidity requirements.

The identification and storage of the information alone, needed for a direct method would require a fully-fledged migration of the various systems' architecture. For large banks, this would to lead to migration costs in the triple digit million range. On an unrelated note, we would also like to point out that IFRS 7 facilitates comprehensive presentations on the issue of liquidity risk. Therefore, we cannot perceive any additional benefit for readers if the cash flow statement were to be based on the direct method. Hence, we feel that the optional preparation of a cash flow statement on the basis of the indirect method shall and must be retained.

Furthermore, we are under the impression that the IASB itself did not fully succeed in implementing the direct method. As early as in IG25 there is reference to the fact that the IASB uses various simplified assumptions in its examples. In the IG32 example (Example 11) the line item “Derivatives at fair value” (page 32) is presented on the balance sheet with the amount of 655 during the reporting period, whilst it was recognised at 315 during the previous period. The delta of 340 is equivalent to the amount presented in the line item "Received from settlement of derivatives" of the cash flow statement (page 33). The change of the derivatives' carrying value is presented as completely cash-relevant. In our understanding, this would mean that the fair value measurement had not resulted in any changes to the carrying amount. One possible explanation for this is that the example shows anecdotal evidence. An alternative explanation would be that, at this juncture, the IASB itself has already simplified to such a degree that said change will invariably have a cash-effect. Is it possible that, already at this stage, the Board has waived the option of reviewing upfront payments or compensation payments within the settlement system or the sub-ledger? It remains doubtful whether cash flow statements prepared in such a way actually offer any value added.

We hold the view that the criterion of decision-usefulness should play a role that is equally pivotal as far as the requested reporting **structure and granularity of the annual financial statements** are concerned. An entity should be given the possibility of presenting its information in a way that provides an appropriate reflection of its business model and the respective activities. As far as the structure proposed for the other elements of financial statements is concerned, please c.f. our comments on the banks' role as financial intermediaries and the resulting caveats for the cash flow statement highlighted above which shall apply accordingly. The enclosed example should underpin our perception.

The disaggregation of the balance sheet requested in the Staff Draft should stay within reasonable bounds lest this would lead to an inflated balance sheet and thus result counterproductive in terms of transparency and information. For instance it remains doubtful if and to which extent banks e.g. are supposed to carry out the requested disaggregation into financing section and operating finance subcategory.

What is more, we feel that the requested **breakdown of individual line items** on the basis of function, nature oder measurement is excessively detailed. For instance, it would lead to an inflated balance sheet thus reducing the latter's perspicuity and meaningfulness if individual line items shall and may only cover assets and liabilities that feature the same measurement bases (cf. BC 142).

Consequently, we hold the view that a corresponding disaggregation in the Notes would be more useful.

Furthermore, we are slightly concerned that the Staff Draft pre-empts part of the discussion on the single statement approach presently conducted in the context of the Exposure Draft "Presentation of Items of Other Comprehensive Income". At this juncture, we would there- fore like to explicitly reiterate the reservations highlighted in our comments dated 24 September 2010.[2] In our view, the planned abrogation of the **two statement approach** does not offer any perceptible benefit over the presentation in one single statement. The large majority of German users prefer the two statement approach. This is due to the fact that it facilitates the differences in the information covered under net income and under other comprehensive income. In addition to this, we are of the opinion that - before implementing any amendment to the optional choice between a single/two statement approach - the Board should provide a concept clarification for the term "performance".

Furthermore, the **disclosures** requested in the **notes** shall and must not lead to any "information overkill". This would be counterproductive since it would keep readers from identifying genuinely decision-useful information. Last but not least, this would result in the risk of wrong interpretations which may lead to wrong decisions. In this context, we feel it is crucial that the disclosure rules be geared towards an entity's respective business model thus allowing financial statement readers to benefit from relevant and decision-useful information.

Feel free to contact us if you have any questions.

Yours sincerely,

For
ZENTRALEN KREDITAUSSCHUSS
Deutscher Sparkassen- und Giroverband
On behalf of

Pia Jankowski

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[2] Cf. ZKA comments on Exposure Draft ED/2010/5 "Presentation of Items of Other Comprehensive Income - Proposed Amendments to IAS 1"

APPENDIX

KI ALPHA

- Standard lending business LAR EUR100 million with EUR15 million interest income
- HTM securities portfolio from own funds investment EUR10 with EUR2 million interest income
- Bank’s operating activities: Refinancing by means of EUR80 million third-party borrowers’ note with EUR8 million interest expenditure
- EUR21 million shareholders’ equity
- EUR9 million equity from profit retentions

Under the Staff Draft proposals, this would result in the following balance sheet structure:

Operating activities	
Assets	110
Claims against customers arising from lending	100
Securities	10
Liabilities	80
Third-party borrower痴 note	80
= Operating activities’ net assets	30
Financing	
Equity financing	30
of which share capital	21
of which revenue reserves	9
= All-in financing	30

Under the Staff Draft proposals, this would result in the following P&L structure:

Operating activities	
Interest income from lending activities	15
Interest income from securities	2
Interest expenditure due to borrowers' notes	- 8
= Result from operating activities	9

= Consolidated profit 9

KI BETA

- Standard lending business LAR EUR100 million with EUR15 million interest income
- HTM securities portfolio from own funds investment EUR10 with EUR2 million interest income
- Bank’s operating activities: Refinancing by means of EUR70 million third-party borrowers’ note with EUR7 million interest expenditure
- Refinancing by means of EUR15 million shareholder’s subordinated capital with EUR2

million interest expenditure as financing activity.

- EUR16 million shareholders' equity
- EUR8 million equity from profit retentions

Under the Staff Draft proposals, this would result in the following balance sheet structure:

Operating activities	
Assets	110
Claims against customers arising from lending	100
Securities	10
Liabilities	70
Third-party borrower's note	70
= Operating activities_ net assets	40
Financing	
Outside capital financing	16
of which subordinated capital	15
of which higher interest payable	1
Equity financing	24
of which share capital	16
of which revenue reserves	8
= All-in financing	40

Under the Staff Draft proposals, this would result in the following P&L structure:

Operating activities	
Interest income from lending activities	15
Interest income from securities	2
Interest expenditure due to borrowers_ notes	- 7
= Result from operating activities	10
Financing	
Interest expenditure due to subordinated capital	- 2
= Result from financing	- 2

= Consolidated profit 8

In our view, this example provides a graphical illustration: From an economic point of view, the performance of both banks' lending business is nearly identical. Yet, under the present proposals on the structure for financial statement presentation, the two banks would report a different operating performance.

However, it is not immediately obvious to us in how far the goal of improved comparability is furthered by a change in performance reporting. This is especially unclear if this performance reporting change is exclusively owed to an alleged standardisation of financial statements and to a reclassification of various – economically speaking largely identical - pieces of information for the purposes of presentation. Quite on the contrary, we are afraid that the proposed new rules might provide the reporting entity with scope for creative judgement in determining the disaggregation [into certain sections, categories or subcategories] that may substantially change the reported subtotals. In our view, this would clearly be a deterioration compared to the *status quo*.

Based on the foregoing, and in view of our presentations on the role of banks in their capacity as financial intermediaries, we feel that the proposals on the design and structure of the financial statements presented in the Staff Draft is inadequate for banks. We therefore object to said proposals.