



DRSC • Charlottenstr. 59 • 10117 Berlin

Hilde Blomme  
Director of Practice Regulation  
Fédération des Experts Comptables Européens  
Avenue d'Auderghem 22-28  
B – 1040 Brussels

Belgium

Telefon +49 30 206412-11  
Telefax +49 30 206412-15  
E-Mail knorr@drsc.de

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Dear Mrs. Blomme,

## **Risk Management and Internal Control in the EU – Discussion Paper**

The German Accounting Standards Committee (GASC) welcomes the opportunity to respond to the discussion paper on Risk Management and Internal Control in the EU.

We agree with FEE that there is a need to promote discussion and evidence gathering to encourage coordination and convergence of the development of risk management and internal control at EU level. As FEE illustrated in Appendix III and X of the above discussion paper, several requirements regarding risk management are already implemented in Germany.

Early on Germany has been eager to implement requirements for companies to provide information about the risk involved in their business activities. Already in 1998 the *Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG - Law on Corporate Control and Transparency)* amended the German Commercial Code (*HGB*) requiring companies to provide information about risks in their management reports.<sup>1</sup> These requirements were specified by issuing the German Accounting Standard (GAS) No 5 *Risk Reporting*<sup>2</sup>, which to date is still the only standard on comprehensive risk reporting world-wide. Only with the Modernisation Directive in 2003 did requirements similar to the requirements of the German Commercial Code become obligatory in all member states of the EU.

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<sup>1</sup> See section 289 of the HGB for individual financial statements and section 315 of the HGB for the consolidated financial statements.

<sup>2</sup> The German Accounting Standards Board (GASB) also issued GAS 5-10 *Risk Reporting by Financial Institutions and Financial Service Institutions* as well as GAS 5-20 *Risk Reporting by Insurance Enterprises*.



So far the risk-relating regulations often focus on the particular risks resulting from market risks. While other risks are needed to thoroughly assess the risk of an entity it is not often subject to regulations. Although the German law and Standards refer to all material risks arising within a company we agree there is a general need for a more comprehensive risk management and reporting approach. Since Germany has tried to enhance and unify the requirements for all companies and is interested in the improvement of these regulations we support FEE's efforts to bring forward these issues.

We would like to comment in more detail on the following issues:

### ***Matrix for analysis***

We believe that the *Matrix for Analysis* is an appropriate instrument to reflect on all aspects of the issue. The matrix can combine the essential and relevant aspects of this matter and can demonstrate the range of management and disclosure of risks possible. However, while we consider this approach appropriate in general, it seems to us that it does not reflect the financial risk as one major type of risk. The matrix includes three types of risk: financial reporting, compliance and operational/strategic risk. The categorization of risk is still widely debated. Hence there are no defined categories. For instance some would subsume the risk in relation to the process for preparing financial reports (financial reporting) within the operational risk. Considering the relevance and the regulations directed particularly towards financial reporting risk we agree with the separation of this particular risk. Nevertheless we do not believe the financial risks – which are subject to the one category of risks which is usually extensively regulated (because it is measurable to a certain degree) – are represented according to their significance in risk management. Therefore we suggest to expand the matrix by the category “financial risk”.

### ***Consideration of the experience of specific industries***

FEE is explicitly not considering regulations concerning a specific industry, e.g. the banking sector. Especially with respect to the banking and insurance sector, we believe it would be a more favourable approach to include the experience of these industries as well as the relevant legal requirements. Since these industries have been the first to address specific risk management and disclosure requirements, the evaluation of these regulations in member states should be at least helpful. We believe this can result in a more thorough suggestion to the EU – although these suggestions address all companies.

### ***Restriction to listed companies***

FEE's suggestions are directed at listed companies. This might be an unnecessary restriction. Considering the existing regulations on the (consolidated) annual report<sup>3</sup> it seems appropriate to expand the scope of the suggestions to the EU according to

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<sup>3</sup> See Article 46 of the 4<sup>th</sup> EU-Directive and Article 36 of the 7<sup>th</sup> EU Directive.



the scope of the EU–Directives. It seems that the implementation of a functioning risk management and internal control is advisable for companies regardless of their size, the suggestions could therefore be directed at all companies. If necessary, modifications for medium-sized entities could be discussed and implemented, which is also the approach taken within the EU–Directive.

### ***Conclusion on the effectiveness of the risk management system***

As described by FEE the German risk management and internal control regulations do not contain the publication of an explicit conclusion on the effectiveness of the risk management system. In general a conclusion on the effectiveness can be appropriate, because it allows for ex-post examinations of the management's insight. But a corresponding requirement seems rather difficult to implement at this point in time, also because solid theoretical procedures of measurement of certain risks (besides financial risks) have not yet been established. In the absence of the possibility to measure risk it does not seem reasonable to include requirements to evaluate the risk measurement. Therefore GASC agrees with FEE that it might not be useful to introduce across the EU effectiveness conclusions on internal control over financial reporting as required by Section 404 of the Sarbanes-Oxley Act.

### ***Consideration of other developments***

In the Discussion Paper FEE lays out an extensive approach to proposals for risk management and internal control regulations. We believe that there are further non-EU developments and activities, besides the Sarbanes-Oxley Act, which need to be observed. In particular the preparations of the IASB Working Group to publish a Discussion Paper on Management Commentary (MC) have to be taken into account.<sup>4</sup> It appears to be important for one because of the possibilities to include relevant aspects also on the EU level. But even more so because European companies preparing financial statements in conformity with IFRS<sup>5</sup> are still required to follow annual reporting regulations by the EU, but will be impacted eventually by these developments.

If you wish to discuss the response further, please do not hesitate to contact us.

Yours sincerely

*Liesel Knorr*  
Secretary General

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<sup>4</sup> See IASB Update June 2005, page 5.

<sup>5</sup> Under Article 4 of the Regulation (EC) No 1606/2002 of 19 July 2002.