

# Accounting Standards Board

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9 February 2006

Dear Alan

## **Discussion Paper 'Management Commentary'**

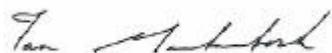
This letter sets out the ASB's comments on the Discussion Paper 'Management Commentary: A paper prepared for the IASB by the staff of its partner standard-setters and others'.

The ASB welcomes the publication of the Discussion Paper. The ASB has long believed that the publication of a narrative explanation of a company's development, performance, position and prospects should be regarded as an important element of best practice in corporate reporting.

The ASB broadly supports the proposals set out in the Discussion Paper. In particular, we support the conclusion that the IASB should add to its agenda a project on management commentary. We support the proposal that the IASB should develop a standard on MC, but – at least initially – we believe any such standard should not be mandatory to assert compliance with IFRS financial statements, although that must be ultimate goal. If the IASB decides to take forward a project on MC, then the Board must work closely with IOSCO and other securities regulators to avoid the danger of a proliferation of MC requirements highlighted by the project team.

Our answers to the questions set out in the 'Invitation to Comment' are set out in the appendix to this letter.

Yours sincerely



**Ian Mackintosh**  
Chairman

## Appendix

### Discussion Paper ‘Management Commentary’: IASB Invitation to Comment

#### **Requirements for management commentary (MC)**

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

We agree that MC should be considered as an integral part of financial reports. As the Discussion Paper makes clear, both the Constitution of the IASC Foundation and the IASB’s ‘Preface to International Financial Reporting Standards’ acknowledge the importance of ‘other financial reporting’ to assist in the interpretation of a complete set of financial statements and to improve users’ ability to make efficient economic decisions.

We agree with the project team’s view of financial reporting (as set out in Figure 1.1 of the Discussion Paper). While MC should be part of financial reports, it should accompany, rather than be part of, the financial statements. This is reinforced by the principle that MC should “supplement and complement financial statement information” (paragraphs 41 to 45 of the Discussion Paper).

The IASB and FASB will be considering the boundaries of financial reporting in a later phase (E) of the conceptual framework project, although on current plans the discussions on this phase are not scheduled to begin until 2007. Should the IASB decide to add a project on MC to its agenda, it will ensure that there is co-ordination between this project and Phase E of the conceptual framework project to ensure a consistent approach is adopted as to what constitutes financial reporting.

##### **Question 2: Should the development of requirements for MC be a priority for the IASB? If not, why not? If yes, should the IASB develop a standard or non-mandatory guidance or both?**

We agree that the development of requirements for MC should be a priority for the IASB and that the Board should develop a standard.

At the time the Discussion Paper was issued, the UK had a statutory requirement for quoted companies to publish Operating and Financial Reviews (OFRs). We are aware that the proposals in the Discussion Paper and the conclusion that a standard is to be preferred to non-mandatory guidance were influenced by the UK regime at that time. Since then, the Government has repealed the statutory requirements for OFRs, although it is currently consulting again on what the future narrative reporting framework should be. That said, legislation remains in place requiring companies to provide MC-type reporting in line with the business review provisions of the EU Accounts Modernisation Directive of 2003. In our view, the conclusion that a standard is preferable to non-mandatory guidance still holds.

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

Yes, although we acknowledge the challenges that this raises, as outlined in Section 6 of the Discussion Paper. As the project team acknowledges, this is an area where an

MC standard in the short-term may have to provide for optional adoption by jurisdictions or entities, although the ultimate goal is for MC presentation to be a prerequisite for assertion of compliance with IFRSs.

### **Purpose of MC**

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

We agree with the objective suggested by the project team.

We believe in principle that the focus should be on the needs of the same primary users as defined in the IASB 'Framework', which is currently being re-examined in the conceptual framework project. On the basis of the current Framework, we agree that the focus on the needs of investors is appropriate. However, as the UK experience has shown, this is a controversial area. In responding to the Exposure Draft of the Reporting Standard on the OFR, a number of commentators argued that directing the OFR at investors would significantly extend the potential liability of company directors such that, in practice, the OFR would involve a level of potential liability equivalent to that arising in a prospectus. In their view, this would encourage a legalistic approach and stifle innovative reporting. In the event, the OFR Reporting Standard came into line with the then legislation, which required the OFR to focus on the needs of a company's current shareholders. In taking forward any project on MC, the IASB would need to consider carefully the user focus for MC and how it fits with the primary users proposed as part of the conceptual framework project. If the definition of primary users is widened as part of that project, there is a danger that the focus of MC reporting could be diluted.

### **Principles, qualitative characteristics and content of MC**

**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 and qualitative characteristics proposed by the project team.

**Question 6: Do you agree with the essential content elements that the project team concluded 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 proposed by the project team.

**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 agree with the approach proposed in the Discussion Paper. The objective is for quality, not quantity of content (as referred to in paragraph A22 of the proposals for an

MC standard set out in Appendix A of the Discussion Paper. The MC standard could also make clear, as the OFR Reporting Standard did, that management will need to consider the key issues to include in MC in order to provide users with focused and relevant information.

**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.**

As noted in the answer to question 2 above, the UK position has changed with the repeal of legislation requiring quoted companies to prepare and publish OFRs, although companies are still required to prepare a fair review of the business in line with EU legislation. Companies can still prepare OFRs on a voluntary basis and the ASB has published best practice guidance in the form of a 'Reporting Statement' on the OFR. The UK requirements and best practice guidance are consistent with the model set out by the project team, although the business review requirements are less detailed.

### **Placement criteria**

**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?**

Yes, the placement criteria are helpful. It is important, however, that the criteria are fully assessed and tested by the project team on the conceptual framework