27 March 2006

ICAEW REP 17/06

Mr Paul Ebling
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Dear Paul

DRAFT EFRAG COMMENT LETTER ON MANAGEMENT COMMENTARY

The Institute of Chartered Accountants in England and Wales welcomes the opportunity to submit comments on the draft EFRAG letter on the IASB discussion paper 'Management Commentary'. The Institute is the largest accountancy body in Europe, with more than 127,000 members The Institute operates under a Royal Charter, working in the public interest.

We have a number of major concerns regarding EFRAG's draft comment letter, in particular in relation to:

- EFRAG's support for a mandatory standard;
- EFRAG's view that the project should be accorded a high priority; and
- The lack of differentiation in EFRAG's responses between listed and non-listed entities, SMEs in particular.

We comment on these three issues in turn below. We have also commented, as requested, on the extent to which we believe that the draft standard is overly-prescriptive.

A standard or non-mandatory guidance?

We do not agree with EFRAG that the IASB should issue a mandatory standard on management commentary in the near future.

In our experience, the market is generally the most effective arbiter of the quality of a company's reporting practices. Investors recognise and reward transparent reporting practices. We consider, furthermore, that any attempt to introduce mandatory requirements on a global scale would be unsuccessful. Practice and market expectations around the world differ markedly in this area, as does the legal environment. In particular, the availability of defences in law for directors making forward-looking statements - which has a major impact on the quality of management commentary - varies between jurisdictions.

We have recommended that the Board publishes an optional standard or statement of good practice on management commentary. A non-mandatory document would permit regulators of management commentary to align their recommendations or requirements over time with an agreed global benchmark. It would also encourage the development of good practice in jurisdictions unfamiliar with the notion of providing the market with balanced and transparent narrative information. We have encouraged the Board to keep the guidance under review as practice develops in this area around the world.

A priority for the Board?

We agree that it is appropriate to encourage companies to provide management commentary alongside their financial statements, subject to cost:benefit considerations and an assessment of user needs. However, we do not agree with EFRAG that the topic should be added to the Board's active agenda.

The Board has many pressing demands on its time, and should not divert resources from more urgent projects, in particular the development of simplified accounting standards for SMEs. We believe that the Board should instead arrange for the project team to finalise their recommendations on management commentary - which we generally support - at an early date. They should then be published as a new type of document in recognition of the fundamental differences in the characteristics of information suitable for disclosure in the management commentary and the financial statements.

An integral part of financial reports? Differentiation

In its response to Question 1, EFRAG emphasizes the importance of management commentary and expresses the view that it is 'an integral part of financial reports'. We agree that a clear commentary issued alongside the annual financial statements is a very important element of the corporate reporting process. However, we believe that EFRAG should recognize that the degree to which it might be regarded as *integral* is dependent on the nature of the reporting entity.

We have urged the Board (if it decides, contrary to our advice, to develop a mandatory standard) to undertake a more rigorous assessment of costs and benefits than that included in Section 6 of the discussion paper. For SMEs in particular, the benefits are very unlikely to outweigh the costs of preparation. In our view, whatever course of action is adopted by the Board, it should not involve imposing new mandatory requirements in this area on all companies that apply IFRS.

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Prescription

In our view, the clear attempt of the project team to limit the degree of prescription in the draft standard - which we applaud - may not have gone far enough. There is a risk that the language used and level of detail will discourage innovative reporting if any element of compulsion is introduced. For example, the list of items that should be included in a description of the business in paragraph A31 and the examples of key relationships in paragraph A42 may encourage a ‘checklist mentality’. The outcome may be a tendency for some directors to focus on compliance with the standard’s detailed requirements - or what come in practice to be regarded as requirements, rather than recommendations or illustrations - rather than developing useful company-specific and sector-specific types of disclosure that enable shareholders and other users to truly view the business 'through the eyes of management’.

We have encouraged the Board to develop high level guidance that is as succinct as possible, incorporating key principles, qualitative characteristics, and clear and concise guidance on contents that is non-prescriptive in tone - ‘may’ or ‘might’ rather than ‘should’.

We will be happy to provide any further information or clarification.

Yours sincerely

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