1 March 2010

Our ref: ICAEW Rep 24/10

Your Ref: ED/2009/06

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Dear Sir David

MANAGEMENT COMMENTARY

The Institute of Chartered Accountants in England and Wales (the ICAEW) is pleased to respond to your request for comments on the ED *Management Commentary*, published in June 2009.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

MANAGEMENT COMMENTARY

Memorandum of comment submitted in March 2010 by the ICAEW, in response to the IASB's exposure draft *Management Commentary*, dated June 2009.

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INTRODUCTION

1. The ICAEW welcomes the opportunity to comment on the IASB's exposure draft *Management Commentary* (the ED).

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. As a world leading professional accountancy body, the ICAEW provides leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures that these skills are constantly developed, recognised and valued.

4. Our members occupy a wide range of roles throughout the economy. This response was developed by the Financial Reporting Committee of the ICAEW, which includes preparers, analysts, standard-setters and academics as well as senior members of accounting firms.

MAJOR POINTS

The value of this project

5. The need for contextual and forward-looking management commentary has increased in recent years. The credit crunch and recent market turmoil in particular have been reminders that the audited financial statements alone cannot provide sufficient insight for capital providers into corporate performance and the longer-term sustainability of businesses.

6. We support the role the IASB has played to date in moving the broader reporting debate forward and note the progress that has been made. We also support the approach taken in the ED, recognising that guidance, rather than a standard, is appropriate. We also agree that the guidance should be built around core principles and a content framework to allow management to determine the most useful information to include in their management commentary.

7. We recognise the key role the IASB plays in influencing the reporting agenda and its positive effect in steering market participants towards coherent reporting. This project gives a profile to management commentary that is helpful, particularly for the many jurisdictions in which management commentary is not yet well-established and which do not have their own guidance or frameworks.

8. However, the IASB has many demands on its time and we acknowledge that this project is probably not its highest priority at present. Nevertheless, we believe that the project does have value and we therefore encourage the IASB to finalise the proposals on a timely basis if this can be done without jeopardising progress on other projects.

Convergence

9. Management commentary is culturally specific. While there is little mention of convergence in the ED, the issue is worth addressing. It is important for a balance to be struck between the benefits of convergence in this area - a high level international framework which would promote a degree of consistency - and the value of company-specific information and management's slant thereon. The proposals take this agenda forward in a constructive manner and we are pleased to see IASB showing leadership in this area. Such leadership will be valuable for those countries that currently do not mandate narrative reporting as it will provide a framework that they could work towards in the future.

Qualitative characteristics and placement principles

10. It would be helpful if paragraph 3 either better explained the notion that management commentary 'is within the scope of the conceptual framework for financial reporting', or avoided the issue; the boundaries of financial reporting within the conceptual framework have yet to be addressed. Subsequent paragraphs attempt to explain how certain qualitative characteristics taken from the framework are to be applied in this context, but it might be better simply to state that the objectives and certain qualitative characteristics within the conceptual framework should be applied to management commentary, as described in the proposals.

11. Notwithstanding the above, we support high-level consistency between the characteristics of financial reporting in the conceptual framework and decision-useful management commentary, but we have concerns about *verifiability* in this context. It suggests an inappropriate level of assurance, given the proposed future orientation of management commentary and the types of forward-looking information that may be included in narrative reporting. It would be better replaced with *supportability*, or similar, as originally proposed in the October 2005 Discussion Paper.

12. We note in other comment letters to the IASB that the lack of a completed conceptual framework is causing problems, so we are disappointed at the deferral of placement principles to Phase E of the project. In the absence of such principles, as the IASB acknowledges, overlap will exist between the type of information that is disclosed in the notes to financial statements and that which is included in management commentary. For example, certain information on financial risk is required to be disclosed by IFRS 7 *Financial Instruments: Disclosures*, but is also likely to be included in management commentary.

13. Consistency between management commentary and the financial statements is also an important issue as entities come to terms with the requirements of IFRS 8 *Operating Segments*. In view of IFRS 8's requirement for measures of segment profit or loss to be the amounts reported to the chief operating decision maker and used to manage the business, we would expect those same measures to form the basis for management commentary. We are aware that certain regulators, such as the UK's Financial Reporting Review Panel, share this view. Hence, we believe that the guidance should make explicit reference to IFRS 8's requirements and include consistency of measurement as a guiding principle.

14. We believe that the interests of users are best served where communication is approached holistically, such that information on a particular topic or item is grouped together in one place. To achieve this objective, there needs to be clarity about what belongs in the notes to the financial statements (information that is essential to an understanding of the elements of the financial statements, as well as the fair presentation of the entity's financial position, performance and cash flows) and what represents management commentary (information that places the results and financial position in context). Without resolving this question, there is a risk that the volume of disclosures may continue to grow with no improvement, or perhaps even deterioration, in the clarity and coherence of the annual report.

Identification of management commentary

15. We do not support the proposal that management commentary should only be made available when it accompanies the financial statements; any restrictions on its use should be subject to local regulation only. We believe that this is unnecessarily prescriptive as management may legitimately wish to use management commentary elsewhere in their communications on corporate performance and prospects, such as in presentations to investors and analysts, and in summary financial reports or accompanying interim financial information. In the UK, the proposal would effectively prohibit the common and helpful practice of issuing narrative information, similar to that included in the full annual report, with summary financial statements. Notwithstanding its role in providing context for the financial statements, we believe that well-written management commentary, prepared in accordance with sound principles, can stand alone. Restrictions as to use are a regulatory matter that should be dealt with at a national or jurisdictional level. Accordingly, we recommend that the proposed prohibition should not be included in the final guidance.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you agree with the Board's decision to develop a guidance document for the preparation and presentation of management commentary instead of an IFRS? If not, why?

16. We agree with the Board's decision to develop a guidance document for the preparation and presentation of management commentary instead of an IFRS. Each company should have the latitude to describe its business in the most appropriate way, within an overall framework. We note that paragraph 1 'prescribes' a framework, which does not seem appropriate language for a guidance document. We believe that 'describes', 'outlines', 'sets out' or something similar would be more suitable.

Q2: Do you agree that the content elements described in paragraphs 24–39 are necessary for the preparation of a decision-useful management commentary? If not, how should those content elements be changed to provide decision-useful information to users of financial reports?

17. We support the proposed content elements described in paragraphs 24–39. They are not vastly different to the issues covered by the UK ASB's Reporting Statement: *Operating and Financial Review*. We note, however, the absence of any substantial discussion of the need to avoid bias, which seems odd of itself, regardless of the rationale behind the comments of dissenting IASB members on neutrality. We note above the need to strike a balance between comparability across entities and the value of management's perspective. The need for comparability should prevent management's perspective becoming biased and some reference, in addition to the existing reference to the framework, might helpfully be made to this.

18. In a similar vein, we believe that the guidance should encourage entities to focus on issues that matter, both good and bad. The concept of materiality is enshrined within financial reporting and the proposed guidance does refer to materiality as a pervasive constraint that limits the information provided in management commentary. However, we believe that a more positive statement should be made that gives materiality due prominence and encourages entities to give proportionate weighting to the matters they report.

19. On an international basis, the elements – resources, risks, relationships, results, prospects, performance measures and indicators – are worthy of comparison with the principles described in the ICGN *Statement and Guidance on Non-financial Business Reporting* issued in February 2009. We believe that the proposals in the ED are broadly consistent with the ICGN's framework and, in the interests of convergence, consider that it may be helpful if this could be acknowledged in the final guidance.

Q3: Do you agree with the Board's decision not to include detailed application guidance and illustrative examples in the final management commentary guidance document? If not, what specific guidance would you include and why?

20. We agree with the Board's decision not to include detailed application guidance and illustrative examples in the final guidance. Furthermore, we would not support any proposal to include such guidance.

OTHER DETAILED COMMENTS

21. Paragraphs 12 and 13 are not well articulated or followed up. They are described as principles but amount to little more than an incomplete list of the content that follows in paragraphs 14 - 20, 24, and 27 - 29. The list of items in paragraph 24 better articulates all of what is covered in paragraph 12 in particular, and might be a better starting point. The principles highlighted in paragraph 13(a) - (c) are expanded in paragraphs 14 - 19, but a further principle is added in paragraph 20 on qualitative characteristics. The list in paragraph 13 at least should be aligned with the subsequent material.

22. Paragraphs 10 and 13, taken together, may give the impression of over-emphasising the future at the expense of the past and the present. It might be better in paragraph 13(c) to acknowledge also the importance of the past and the present.

23. On the same subject of future orientation, paragraphs 17-19 need to recognise the lack of safe harbour in most jurisdictions.

24. To be consistent with terminology used in IFRSs (for example, IFRS 9 *Financial Instruments*), paragraph 26(e) should refer to the business model rather than the economic model.

25. Paragraphs 36 - 39 acknowledge that the performance measures actually used by management are most helpful to users. This guidance implies that such measures may be 'non-GAAP', which is helpful. However, in view of IFRS 8's requirement for measures of segment profit or loss to be the amounts reported to the chief operating decision maker, we would expect there to be consistency between the management commentary and segment reporting in the financial statements. We are aware that certain regulators, such as the UK's Financial Reporting Review Panel, share this view. Hence, we believe that the guidance should make explicit reference to IFRS 8's requirements and include consistency of measurement as a guiding principle.

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