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

Dear Sir David

Discussion Paper: Management Commentary

We are pleased to comment on the International Accounting Standards Board's (the Board's or IASB's) *Discussion Paper: Management Commentary* (referred to as the discussion paper), as prepared for the IASB by staff of its partner standard setters and others. Our responses to the questions raised in the discussion paper are set out in the Appendix to this letter.

We believe it would have been helpful if the discussion paper indicated the extent to which its content had been debated by the Board. We note that providing guidance on management commentary (MC) is a considerable leap from the standard-setting activities that have previously been undertaken by the Board, and we would have appreciated it if the document had suggested the extent to which the Board members themselves support taking this step.

In summary, we do not believe the development of an MC standard is an appropriate task for the IASB at this time, if ever. We believe that the desirable content of MC is driven by cultural factors and expectations about how companies should do business. We therefore consider that the form and content of MC should continue to be regulated by local or regional regulators. We believe that the amount of IASB staff and Board time that would be consumed by the project is not justifiable until such time as the Board has completed some of the more contentious projects currently on its agenda. Should this item become an active Board project in the future, we would strongly recommend that the IASB staff work with a selection of local regulators in developing the requirements.

If you have any questions concerning our comments, we would be pleased to discuss them.

Sincerely,

Ken Wild
Global IFRS Leader

APPENDIX

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 an integral part of regular reporting by entities to stakeholders. We believe that ordinarily, MC should be provided to stakeholders together with the financial statements prepared under IFRS. However, as 'Financial Reports' is not a defined term within IFRS, and the provision of such information comes in a myriad of formats and reporting packages in different countries we do not agree with this proposal.

If the IASB was to conclude that MC is an integral part of the financial report, amendments to paragraph 7 of the Framework, and paragraphs 8 and 9 of IAS 1 *Presentation of Financial Statements* would be required.

Question 2

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

We do not believe the development of requirements for MC should be a priority for the Board. We note that at the December 2005 Board meeting the Board considered a technical plan for the resolution of known accounting issues. That plan was considered to be 'optimistic'. In the course of that meeting Board members noted that the resolution of some of those issues might be up to five years away. We believe it would not be appropriate at this time for the Board to widen the range of reporting it deals with – rather, resources should be directed to improving those aspects of financial reporting which are more contentious and currently on the Board's agenda.

We believe that if MC is ever added to the Board's active agenda, this should not occur until such time as sufficient staff resources and Board time can be made available to dedicate to this project. The quantum of dedicated resources would need to be such that the project would progress within a reasonable time frame without having detrimental effect on other projects. Furthermore, we note that MC is an item which has been regulated differently in different countries for many years, and we believe that cultural differences would have a significant impact on this project, thus further slowing its progress. While we acknowledge that such diversity in practice is not ideal, we believe that the nature of the changes to local regulation that would be required are unlikely to obtain widespread support in the foreseeable future.

We do not believe that the quality of MC provided, nor the regulation which accompanies it in many jurisdictions, is sufficiently poor to justify the use of IASB resources at this time. We note that the discussion paper does not explain why this project might be considered a priority, and we are therefore unable to respond to any specific reasons the authors may have had in mind.

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.

For the reasons cited below we do not believe that entities should be required to include MC in their financial reports in order to assert compliance with IFRS. We believe that the requirement to provide MC should be regulated by local or regional regulators. The IASB should not impose mandatory MC on any entity. In the following paragraphs we set out our reservations about requiring MC in order to assert compliance with IFRS.

The audit issues associated with requiring that financial reports include MC in order to assert compliance with IFRSs are far more significant than the paper makes out. Furthermore, the MC requirements proposed are more far-reaching than those currently subject to audit in various countries around the world.

Given that the information in the MC is largely driven by the opinions of management and includes judgements, particularly in respect of 'soft' rather than 'hard' or historical information, this information may be so subjective as to require auditors to modify their reports on the grounds of fundamental uncertainty or limitation of scope, with such modifications becoming standard. We believe this would result in the audit being undervalued. Indeed it may not be possible to provide assurance on the MC within the International Auditing and Assurance Standards Board’s (IAASB) framework which requires that the criteria for evaluation of a subject matter needs to be relevant, complete, reliable, neutral and understandable. If MC was required in financial reports in order to assert compliance with IFRS, it would have to be subject to an appropriate level of assurance as part of the audit of the financial statements. Without such assurance, auditors could not conclude as to whether the MC complied with the IASB's requirements and therefore whether the assertion of compliance with IFRS was appropriate.

The nature of the information in the MC goes beyond the historic information which forms the basis on which reports under International Standards on Auditing are currently issued. We believe that if MC were required in financial reports in order to assert compliance with IFRS, an additional appropriate International Standard on Auditing MC would be required. We do not think, in the absence of such a standard, mandatory compliance with an MC standard under IFRS would be achievable. Furthermore, we do not believe it would be appropriate for this change in the scope of an audit to effectively be driven by the IASB. Finally, it is worth noting that the auditing of MC would involve an increase in audit time and cost of the order likely to be that required by Sarbanes Oxley 404.

In many jurisdictions, MC is only required for entities of a certain size, or with certain stakeholder characteristics (such as being publicly listed). These stakeholder characteristics are substantially different to those being considered by the IASB to define Small and Medium Sized Entities. (We presume SMEs would be exempt from most or all MC requirements.) This would leave a substantial number of entities which do not currently have MC reporting requirements that would be required to prepare MC in order to comply with IFRS. In the light of the fact that local regulators consider it unnecessary for certain types of entity to prepare MC, we believe it would be both onerous and inappropriate for the IASB to require all entities asserting IFRS compliance to prepare MC. We therefore respectfully request that if the IASB does proceed to require MC in order to assert compliance with IFRS comprehensive research be undertaken to identify the characteristics of entities which would be required to prepare MC. We would strongly object to any assertion that all entities must prepare MC in order to comply with IFRS.

In many jurisdictions, MC requirements already exist which might be more comprehensive than those developed by the IASB. Local regulators may be reluctant to allow information they have previously required to be omitted as a result of the IASB introducing its own requirements. We note that reporting on different items will be considered to be important in different regions based on business and cultural factors. We do not believe the IASB could issue an MC Standard that would meet a cost/benefits analysis for countries with no MC requirements, as well as meeting the specific needs and requirements of countries which have existing requirements.

We also note that the comfort taken from the Regulatory Impact Statement in relation to the Operating and Financial Review (" the OFR") in the United Kingdom is no longer justifiable. As the IASB will be aware, the UK mandatory requirement for an OFR has been removed in response to significant pressure from business leaders in the UK about the ever increasing burden of business regulation. The OFR was seen as one aspect of business regulation which could be withdrawn without significant detriment to overall business regulation – we therefore believe that this indicates that the benefits were not, in the end, perceived to outweigh the costs. We therefore respectfully request that the cost/benefit of requiring MC be reconsidered in the light of this development. Additionally, with regards to our comments on auditing MC above, even while the OFR in the UK was mandatory, the decision was taken that it should not be subject to audit as it was considered not to be auditable.

We draw your attention to the UK study prepared by the All Party Parliamentary Corporate Governance Group (APPCGG). This study showed that participants believed the OFR would not add meaningful information to that already held by analysts. Neither investors nor corporate respondents believed that the provision of an OFR would improve public trust in corporate executives. One of the key benefits of the OFR was perceived to be the focussing of management attention on the key risks to the business, rather than the use of the review itself. Furthermore, most companies were concerned that there was no 'safe harbour' provision exempting management and auditors from liability in respect of certain aspects of the OFR. It therefore appears to us that the key perceived benefits, and the key concerns, are not items over which the IASB could have any jurisdiction. We would therefore conclude that at this time, local or regional regulation of business activities is a more appropriate forum for the development of MC requirements.

We believe there will be many interpretation issues arising from an MC requirement within IFRS. We would strongly oppose any development which would, having consumed a significant amount of IASB time, goes on to consume a significant amount of IFRIC time. We believe there is a high risk of a large number of requests for interpretations arising from the MC requirements, and that the main driver behind such requests will be differences in business cultures.

Purpose of MC

Question 4

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

We agree with the objective suggested by the project team. We note that the focus on the needs of investors is consistent with the results of the research presented by the CFA Institute at the October 2005 Joint Board meeting in Norwalk. We concur that investors are an appropriate focus for financial reporting, and believe that other stakeholders will be able to obtain much of the information they desire either from reports prepared with investors in mind, or from other sources available to them.

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?
In general we agree with the principles and qualitative characteristics that the project team concluded are essential to apply in the preparation of MC.

We do not understand the need for 'supportability' as a qualitative characteristic. We do not believe that information that is considered to be reliable (as required by paragraphs 73 -74) is likely to be unsupportable.

On the topic of comparability, we agree that there are a number of non financial measures and non-IFRS financial measures which have been calculated inconsistently around the world, and we believe that providing an explanation as to the methodology used in arriving at these measures should be a requirement. However, we note that there are certain non-IFRS financial measures which should reconcile directly to measures included in the IFRS financial statements. For example, where an entity discloses EBITDA on the face of their statement of financial performance, a disclosure of EBITDA in the MC must be the same number, irrespective of the fact that EBITDA is a financial measure not defined by IFRS. Similarly, if EBITDA is not disclosed in the financial statements, but is disclosed in the MC, the figure in the MC must be derived from profit and loss measures that are acceptable under IFRS. We believe that any standard requiring MC as part of the IFRS financial statements should strongly emphasize the need for financial measures used in the MC to be readily reconcilable to those used elsewhere in the financial statements. However, we note that traditionally, the need for such consistency has been appropriately addressed as an audit issue and we do not believe that this aspect is within the IASB's mandate.

We agree with the assertion in paragraph 94 that changes in indicators should not occur every year, but would be triggered by events such as a comprehensive strategic review. However, we note that we would consider it reasonable for there to be some changes in the indicators used during the first few years of preparing MC. This would reflect the fact that with experience, management become more acutely aware of those indicators that are useful to investors and those that are not. Furthermore, other circumstances might warrant a change in the indicators used – such as a major restructuring, or significant changes in the industry. We believe that entities should be discouraged from changing the indicators they use. However, they should be permitted to change indicators when management believes the change will provide more meaningful information to users. Any such change should be disclosed, together with the justification for the change.

Question 6
Do you agree with the essential content elements that the project team concluded that the 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 that the project team concluded the MC should cover.

We are concerned at the proposal that the IASB should develop guidance to demonstrate that there are many ways to achieve the objective of the MC. The development of such guidance is likely to significantly delay the completion of the project, and we question the appropriateness of this activity. The IASB has traditionally refrained from providing extensive guidance about a range of possible methods, and to spend significant time on the development of such guidance will set a precedent the IASB will be hard-pressed to sustain. Furthermore, we are not sure why such guidance would be considered necessary.

We do not agree with the assertion that future guidance may be required to standardise various non-financial performance measures and non-IFRS financial performance measures. We do not believe that the IASB should dedicate resources to such an activity. Where considered significant, securities regulators introduce regulation that has the effect of standardising the measures. Many believe that IAS 33 *Earnings per Share* is not an appropriate accounting standard and should never have been developed. To devote significant resource to standardising other measures, some of which are even more loosely related to IFRS numbers than Earnings per Share, would be to invite significant criticism as well as detracting from resources available to other projects.

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 that MC should highlight the most important information, and should not contain superfluous information which confuses the key messages. We believe that requirements to this effect should be included within any MC standard.

We believe that the project team should develop some guidance as to the characteristics of information which is useful and necessary, and the characteristics of information which is unhelpful. Such characteristics should be described in the 'principles and qualitative characteristics' section of the MC standard. A suggested method of articulating this characteristic is as follows:

> Information provided in the MC should be useful to readers in achieving the objective described in paragraph A7. Additional or superfluous information may be misleading, and will almost certainly detract from the key messages. Management should consider the following criteria when determining whether information is useful.
>
> Information is considered useful when:
> (a) it provides the user with insight into drivers behind the past, present or expected future performance of the entity;
> (b) it provides the user with measures of performance which can be compared between entities and between periods;
> (c) it provides the user with specific details about new business activities or activities which have been discontinued during the year;
> (d) …
>
> Information is considered unhelpful when:
> (a) it provides the user with specific details which are relevant to the running of a particular minor ongoing business of the entity, but not the overall entity itself;

> (b) it provides the user with detailed technical information about the business activities which a reasonable user is not expected to understand;
> (c) …

We do not support the inclusion of any prescriptive requirements as to how key information should be highlighted. We believe that management must identify the key information and highlight this in a manner which is most appropriate to their business, reporting style and cultural setting. Similarly, we do not support any explicit limitations on the information to be provided. We believe that describing the characteristics in a manner similar to that shown above will provide a more helpful framework within which management can develop MC.

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.

In the light of the fact that the Deloitte response is submitted on behalf of member firms in 148 countries, significant effort would be required for us to comment on this in a comprehensive manner. Consistent with our views about this project being an inappropriate use of IASB resources at this time, we also feel it would be inappropriate for us to dedicate significant time to providing answers to this question which would reflect the situation in every country in which Deloitte is represented. However, if the IASB continues with this project, we strongly believe that comprehensive research into existing local requirements in a wider range of countries than those listed in the discussion paper should be undertaken.

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?

We disagree with the proposal for placement criteria. We believe that where the IASB believes information should be disclosed as a result of an accounting standard, it should be disclosed within the financial statements. The information required to be disclosed by accounting standards is ordinarily very detailed and very specific. To permit or require its inclusion within the MC would be to risk clouding the communication of the key information that management has identified as being important.

Where the IASB identifies information that it believes should be included within MC in the course of developing an accounting standard, a consequential amendment to the MC standard should be made to require the disclosure. In this context we agree with the criteria set out in paragraph 169. However, in applying the placement criteria, we would urge the IASB to be continually mindful of ensuring that the MC is not overburdened with required information in a way that would discourage management from providing additional information that would meet the objectives of MC.

We believe there is an additional solution to avoid the repetition of information in both the financial statements and the MC which does not appear to have been considered. We believe it would be possible for the financial statements to cross refer to a specific section of the MC, and that section would then be considered to form part of the financial statements (that is it is part of the information prepared by the entity in order to comply with IFRS) although located within the MC. This would then allow management to determine when information required by IFRS is more appropriately placed within the MC, and when that information should remain within the financial statements. Whilst the wording to achieve this would need to be carefully drafted (particularly if MC was not considered to form part of IFRS), we believe that this is an alternative which should be explored.

We believe that the usefulness of the example in paragraph 175 could be improved. The example discusses the information that is required to be disclosed about property, plant and equipment in the financial statements. This example could be usefully extended to point out that information about planned renewal or capital investment would ordinarily be found in the MC.

Additional Comments

We are concerned by the suggestion in paragraph 31 that the IASB would mandate which items within a financial report could be labeled as MC, to the exclusion of those items required by local regulators. This in fact is more restrictive than the requirements relating to financial statements. It is our belief that an entity may incorporate within its financial statements items that are not specifically required by IFRS (subject to those items not being explicitly excluded from financial statements, as explained in paragraph 7 of the Framework). To suggest that entities could not include information required by a regulator within MC unless it is specifically required by the IASB's MC standard is unnecessarily restrictive.

We do not believe that the comment in paragraph A22 that 'the objective is quality rather than quantity of MC content', adequately conveys the meaning intended. We believe some of the discussion in paragraphs 65 – 72 of the Discussion Paper should be included to clarify what is meant by this comment.

We request that the reference to a 'content map' in paragraph A28 should be changed to a 'table of contents' as this is a more commonly used and understandable term.

The requirement in paragraph A46 to provide information including targets for key financial and non-financial measures is unclear and potentially onerous. It is not clear whether the 'key financial and non-financial measures' implies all such measures in MC (on the basis that if they are not key they should be excluded for the purposes of clarity) or whether this refers to only a selection of the measures provided. Furthermore, the requirement to provide specific targets may cause a lot of market concern. The disclosure of targets is not comparable information, as the optimism with which management approach this disclosure will have a large impact on the targets disclosed, but not on the actual outcomes in future periods.