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Mr. Steve Ong
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Hong Kong Institute of Certified Public Accountants
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Dear Steve,

IASB Exposure Draft on Management Commentary (“Exposure Draft”)

I refer to your letter dated 30 November 2009 on the above to our Mr. Archie Tsim which has been passed to me for my attention.

We have completed our review of the Exposure Draft and our views are set out in the paragraphs below.

General

The Exposure Draft proposes a framework to assist management in preparing a management commentary to accompany financial statements. It is proposed that the framework will become non-mandatory guidance, rather than a mandatory standard.

We agree that a management commentary is an important narrative to supplement and complement financial statements. The proposed guidance recognises that financial statements alone do not effectively communicate to readers in simple layman terms the performance of an entity as well as management's objectives and its strategies to achieve its objectives. We appreciate IASB's goal to improve the usefulness of the information provided in financial reports and the work done by IASB. However, we consider that developing the framework as a guidance document only may not be sufficient to promote or encourage disclosures beyond what is required in financial statements which we understand is the objective of the framework. We therefore suggest that the framework should be developed as a mandatory standard or at least a “comply or explain” code of best practice.

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In addition, we consider that the Exposure Draft lacks examples to clarify and further explain how the principles in the framework should be applied. We also believe that application guidance and illustrative examples are helpful and should be included. Our detailed comments are discussed further below.

Status of the framework

The Exposure Draft proposes that the framework will be issued as a guidance document instead of a standard. We believe that the project to develop the Exposure Draft was made because it was recognised that financial statements alone without further narrative explanations are insufficient in communicating the performance of an entity as well as explaining management's objectives and its strategies, and the progress or outcome of implementing management's strategies.

In order to make the framework more effective and to achieve its objective, we believe that the framework should be issued as a standard. Alternatively, it should be released as a "comply or explain" code of best practice so that companies are encouraged to take positive steps to comply with the code or explain the reasons why they believe that financial statements alone will enable readers of financial reports make informed investment decisions. We note that investors are interested in information on an entity's past, present and the future prospects and they need narrative commentaries on the prospects of the business so that they can make informed investment decisions. We accept that the management commentary represents management's view and management should be given some leeway to make their own judgements on what kind of information and how the information should be presented, but we believe minimum relevant information should be provided.

More examples would provide greater clarity

We find that the Exposure Draft is generic and inclusion of examples would facilitate a better understanding of the principles. For instance, paragraph 12 of the Exposure Draft states that the management commentary may help users of the financial reports to understand:-

- "(a) the entity's risk exposures, its strategies for managing risks and the effectiveness of those strategies;*
- (b) how resources that are not presented in the financial statements could affect the entity's operation; and*
- (c) how non-financial factors have influenced the information presented in the financial statements."*

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and paragraph 16 states that the “*management commentary includes financial and non-financial information about the entity and its performance that is not presented in the financial statements.*”

It is not entirely clear what is meant by “*resources not presented in the financial statements*” or “*non-financial factors*” and inclusion of some simple examples would be helpful.

We believe that by providing examples entities will be in a better position to understand and apply the principles and this will encourage management to brainstorm ideas and include relevant decision-useful information in their management commentaries. In addition, we believe examples of commonly used performance indicators, grouped by industry, would be useful.

Application guidance and illustrative examples

BC48 of the Exposure Draft explains why IASB decided not to include application guidance or illustrative examples in the Exposure Draft.

We understand the IASB’s concerns were that application guidance or illustrative examples may be interpreted either as a floor (minimum requirements) or a ceiling (the only disclosures for inclusion in a management commentary). However, we consider that as the Exposure Draft as drafted is quite general, entities may have difficulty in applying the framework and there may be different interpretations of the guidance. We therefore believe inclusion of illustrative examples will make the guidance more useful and meaningful and will assist companies to gain a better understanding of how to apply the principles in practice.

Another reason stated why the IASB decided not to include application guidance or illustrative examples was that IASB considered that the development of such application guidance or illustrative examples is best left to other organisations. We do not agree with this approach. We consider that if application guidance or illustrative examples is developed by other organizations rather than IASB, this is likely to lead to inconsistency and confusion, which will result in less useful and possibly misleading management commentaries. The paper did not mention which organizations could provide such application guidance and their authority to do so.

Accordingly, we consider that IASB should include appropriate application guidance and illustrative examples. To alleviate the IASB’s concerns that the illustrative examples may be interpreted as a floor or a ceiling of disclosures, we would suggest that an appropriate warning clause could be added. We would note that IASB in many cases has included application guidance to support and explain the accounting standards it has issued.

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Scope

The Exposure Draft states that the framework *“has been developed to apply to publicly traded entities”*.

The objective of the Exposure Draft is to enhance the usefulness of financial reports and we believe the principles can be applied to a wider range of financial reports. We believe the framework should not be confined to publicly traded entities but could be extended to include public interest entities which may be defined as *“entities that are of significant public relevance because of the nature of their business, their size or their number of employees, in particular companies whose securities are admitted to trading on a regulated market, banks and other financial institutions and insurance undertakings.”* We also believe that the framework would also be relevant to entities where there is separation of ownership and management.

Time frame

The Exposure Draft proposes that the management commentary should communicate information about the past, present and future. We agree with this. However, we believe that it would be useful to specify a cut-off date and a suggestion would be information and views of the directors up to the date they approve the financial statements.

We hope that the above comments are helpful.

Yours sincerely,
For and on behalf of
The Stock Exchange of Hong Kong Limited



Colin Chau
Senior Vice President
Listing Division

CC/el

c.c. Mr. Archie Tsim – Chief Financial Officer
Mr. Mark Dickens – Head of Listing