Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

By e-mail and by post

28 April 2006

Mr. Alan Teixeira
Senior Project Manager
International Accounting Standards Board,
30 Cannon Street,
London EC4M 6XH,
United Kingdom.

Dear Mr. Teixeira,

Comments on IASB Discussion Paper: Management Commentary

The Hong Kong Institute of Certified Public Accountants welcomes the opportunity to provide you with our comments on the captioned Discussion Paper. Our responses to the questions raised in your Invitation to Comment are set out in the appendix for your consideration.

In general, we appreciate the initiative of the IASB in taking up a project on Management Commentary (MC). However, given the IASB's limited resources, we do not consider development of requirements for MC should be a priority for the IASB. In our view, the IASB's priority should be to resolve issues and problems relating to the application of international financial reporting standards (IFRSs) to general purpose financial statements. In view of the nature of MC, we consider that the project could be driven or undertaken by a body such as IFAC, rather than the IASB.

We are generally supportive of the proposals for MC characteristics and content. However, we would have concerns if auditors are required to audit or verify the information to be included in the MC in order to enable them to form an opinion on compliance with IFRSs. We consider that it would be better if the proposals are to be issued by a respected international body as a non-mandatory best practice guide. Relevant regulatory authorities within each jurisdiction could then determine the way(s) to enforce this guide if considered appropriate.

If you have any questions on our comments, please do not hesitate to contact me at patricia@hkicpa.org.hk.

Yours sincerely,

Patricia McBride
Director, Standard Setting
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PM/EH/al

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APPENDIX

Hong Kong Institute of CPAs

Responses to the questions raised in the IASB Discussion Paper on Management Commentary

General

Q 1: Do you agree that Management Commentary ("MC") should be considered an integral part of financial reports? If not, why not?

We agree that MC should sit alongside the financial statements and should be considered an integral part of financial reporting, particularly by listed companies. However, we consider that MC should not form part of the financial statements upon which auditors need to form an opinion. Please see also the responses below.

Q 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 appreciate the initiative of the IASB in taking up a project on MC. However, given its limited resources, we do not consider development of requirements for MC should be a priority for the IASB. The IASB's priority should be to resolve issues and problems relating to the application of international financial reporting standards (IFRSs) to general purpose financial statements. In view of the nature of MC, we consider that the project could be driven or undertaken by IFAC, rather than the IASB.

Q 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.

No, as we do not consider that the IASB should develop MC pronouncements, we do not consider that entities should be required to include MC in their financial reports in order to assert compliance with IFRSs.

As defined in the Preface, IFRSs set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events that are important in general purpose financial statements. Although we agree that MC should supplement and complement the information contained in financial statements, we do not consider MC should have a primary role in dealing with matters concerning general purpose financial statements. Accordingly, we believe that MC should fall outside the scope of IFRSs.

In addition, information to be disclosed in MC might relate to business strategy, economic environment, environmental policies and performance, corporate social responsibility, forward looking business prospects and market trends that is very difficult, if not impossible, to verify. Accordingly, if MC was to be included in the scope of IFRSs, it might create difficulties for the auditor in forming an opinion on fair presentation and compliance with IFRSs. Further, it is likely to lead to 'tick-box' reporting rather than the disclosure of useful information.

Purpose of MC

Q 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 except that we believe the focus should not be solely on the needs of investors. We consider that MC should take into account of the needs of a wider range of users similar to the range of users of financial statements as envisaged under the IASB Framework.

Q 5: Do you agree with the principles and qualitative characteristics that the discussion paper 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?

While we agree, in general, with the principles and qualitative characteristics proposed, we consider that the principles themselves are not totally clear. One of the principles under the discussion paper is that MC should be written through the eyes of management. We believe that the term “management” should be more clearly defined as relating to the governing body or the executive team. While we agree that MC should have an orientation to the future, we believe that it would be helpful to make clear that an explanation of past events and an analysis of the current performance and the factors and trends underlying that performance in MC are also important although this information could be covered under the principle of supplementing and complementing financial statement information.

We also have some concerns about the principle of MC having an orientation to the future as this may be interpreted as making forecast or projections that, in many jurisdictions, are subject to very strict rules and regulations. Accordingly, we suggest the guidance should clarify this aspect. In addition, jurisdictions should be encouraged to develop “safe harbour” provisions to restrict liability claim and regulatory provisions that require cautionary statements relating to forward looking information. These involve identifying the forward-looking information as such, explaining the assumptions that were applied, and any material factors that could cause results to differ. Without such provisions, entities are unlikely to prepare useful forward-looking information.

Q 6: Do you agree with the essential content elements that the project team concluded that 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. However, we would like to see more guidance on demonstrating the essential content elements of MC and on standardising performance measures and indicators. We also consider disclosure of the corporate governance framework or infrastructure that is in place to help ensure that an entity is able to accomplish its objectives and strategies is important for the MC, if such disclosure is not included elsewhere in the financial report. We understand that, in some jurisdictions, corporate governance disclosures are made in a separate statement or section of the financial report. In that case, we believe that certain cross-references between MC and corporate governance section / statement should be made, where appropriate.

Q 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 consider the quality of information is the key rather than quantity. We do not consider it necessary to provide specific guidance or requirements to limit the amount of information to be disclosed within MC. However, it might be useful to make clear that management will have to consider the key issues to be included in MC in order to provide users with focused and relevant information.

Q 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 Hong Kong, the Stock Exchange Listing Rules require a listed company to include a separate statement in its annual report containing (i) a discussion and analysis (MD&A) of the group's performance during the financial year and (ii) material factors underlying its results and financial position. A listed company should emphasise trends and identify significant events or transactions during the financial year under review. The Listing Rules also list out the items that MD&A should, as a minimum, include as well as some recommended additional disclosures. The minimum items to be included in MD&A are:

- Liquidity and financial resources
- Borrowing and its maturity dates
- Capex commitments and authorizations
- Capital structure, funding and treasury policies, currency risk, interest rate risk, hedging, etc
- Order book, prospects of new business, products and services
- Significant investment held and performance
- Comments on segmental information and analysis
- Number and remuneration of employees
- Details of charges on group assets
- Plans of future investments, expected source of funding
- Gearing ratio
- Exposure to fluctuations in exchange rates
- Details of contingent liabilities

Unlike the Listing Rules in Hong Kong, the proposed model in the discussion paper is principles-based and provides an MC disclosure framework for the management to consider when preparing and presenting MC. The proposed model relies on management to decide what information should be disclosed, and how it is presented, within MC.

In addition to MD&A, HK Stock Exchange Listing Rules also require the disclosure of a separate Corporate Governance Report in the annual report, disclosing the corporate governance structure and practices and other corporate governance information of a listed entity. However, the disclosure of corporate governance information is not covered in the discussion paper. Please see also our response to question 6 above.

Placement criteria

Q 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 are of the view that the placement criteria, as suggested in the discussion paper, for distinguishing information to be disclosed in the MC and in the notes to the financial statements are not particularly helpful.

We consider that all disclosures that are considered necessary for the financial statements to provide a true and fair view should be included in the notes to the financial statements and covered by IFRSs. If particular information included in the notes is considered to be important to users of MC, and those users are considered unlikely to read the notes, then such information should be replicated in the MC or reference could be made in the MC to the relevant notes to the financial statements.

On the other hand, we consider that disclosures other than the above that would enhance the understanding of the entity and its business could be included in MC. However, the information to be included in the MC should not be required to be audited, although some checks to ensure that those disclosures are consistent with the information disclosed in the financial statements would be helpful.

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