MANAGEMENT COMMENTARY: IASB DISCUSSION PAPER

Comments from Standard Life Investments, Edinburgh, Scotland

(To be read in conjunction with the letter from Standard Life Investments dated 15 March 2006)

Requirements for Management Commentary (MC)

Q1. Do you agree that MC should be considered an integral part of financial reports? If not, why not?

Yes. As primary users of financial reports, the type of information envisaged for MC provides us with not only improved accountability but also relevant information to assist our decision-making. Currently, institutional investors often have 1:1 meetings with the senior management of companies to discuss many of the topics that are likely to be addressed in MC. Therefore, to require MC to be prepared and to be accessible to all users will help to further level the information playing field, especially as it pertains to listed companies.

Q2. 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?

Yes, the development of requirements for MC should be a priority for the Board. The MC is a very important part of the corporate reporting jigsaw. The absence of any requirements pertaining to MC from standard-setters is a notable and significant omission. Furthermore, it is our understanding that many preparers of financial reports are generally supportive of the proposals, which indicates a welcome degree of consensus between users and preparers. Consequently, the IASB should be able to progress the proposals through to an authoritative statement with reasonable haste and lack of controversy.

On balance, we should prefer non-mandatory guidance, provided that the guidance is accompanied by an effective audit review standard, designed to ensure that MCs prepared in accordance with such guidance can be relied upon by users. (Our views on audit review requirements are set out below.) The benefit, from our perspective, of non-mandatory guidance is that it creates a benchmark of best reporting practice against which companies can exercise flexibility and discretion to tailor their commentaries to their particular requirements whereas a standard may tend to result in 'boilerplate' disclosures, which tend to comply with the form rather than the substance of the reporting requirements.

In the light of the previous comments, we should like to underscore the importance of having an effective audit review regime to complement the IASB's guidance. Accordingly, on this matter in particular, we encourage the IASB to liaise closely with the International Auditing & Assurance Standards

Board ('IAASB') with a view to the IAASB issuing draft audit guidance at or around the same time as the IASB's MC proposals. In this context, it is relevant to note that the UK requirements, as summarised in paragraph 188, provide users with an appropriate 'light touch' assurance regarding the content of MC. A lighter touch audit review approach would not be appropriate, especially given the forward looking information and the conflicts which can arise regarding the presentation of such information. A heavier approach would tend to discourage useful disclosures being made in the MC.

Q3. Should entities be required to include MC in their financial reports in order to assert compliance with IFRSs? Please explain why or why not.

Yes. As mentioned in response to question 1 above, we regard MC as an integral part of financial reports. As global investors, comparability of accounting information is one of the major perceived benefits of IFRS. To make the MC a wholly voluntary statement would undermine seriously the benefits of IFRS comparability. Furthermore, to exclude MC from the assertion of compliance with IFRS would call into question whether financial reports prepared in compliance with IFRS could ever achieve fair presentation of the entities' financial positions.

Purpose of MC

Q4. 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?

Yes, we agree with the objective that is discussed and described in paragraphs 32-35. The suggested objective is straightforward and unambiguous, which are commendable qualities.

The focus on the needs of investors is appropriate. This focus should help preparers when compiling and presenting information.

Principles, qualitative characteristics and content of MC

Q5. Do you agree with the principles and qualitative characteristics that the project team concluded are essential to apply in the perception of MC? If not, what additional principles or characteristics are required, or which ones suggested by the project team would you change?

We agree with the principles and qualitative characteristics that the project team concluded are essential. However, there are 3 points of emphasis that we should like to communicate:

- We support 'through the eyes of management' as a guiding principle on the presumption that 'management' in this regard refers to the 'board of directors'. In a number of jurisdictions the term 'management' is used to

- refer to 'the board' whereas in other jurisdictions it refers solely to 'executive management' – and the vision of these two groups can sometimes differ significantly. To avoid any ambiguity in this regard, an appropriate definition and/or clarification of 'management' would be useful.
- As stated in paragraph 57, the forward-looking aspects of the proposals will be influenced by the regulatory and legal environment within which the entity operates. 'Safe harbour' provisions are, as noted in the Discussion Paper, relevant in the context of forward-looking information. We understand the benefits that can accrue from 'safe harbour' provisions but we are mindful of the scope for abuse that such provisions provide. Hence it is important that if 'safe harbour' provisions are adopted in certain jurisdictions that they are accompanied by appropriate checks and balances designed to ensure fair presentation of the information. Perhaps this could be pinpointed in the commentary that accompanies any authoritative statements by the Board on MC.
- The previous comment is addressed to a degree in paragraph 78 where it is stated that 'the tone or style adopted in narrative reporting is very important' in terms of providing an evenhanded commentary without any overemphasis on positive views. This underscores the importance and relevance of the light touch but effective audit review approach that we refer to in our response to Q2.

Q6. 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 that are listed in Section 4.

Q7. 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 do not think it is appropriate to provide guidance or requirements to limit the amount of information within MC. We have a strong preference for a principles based approach to information disclosure. Furthermore, the provision of guidance or requirements to limit the amount of information may be used inappropriately by certain preparers since it may provide unintended loopholes to enable such preparers to side-step difficult disclosures that should otherwise be made in order to achieve fair presentation.

That said, investors need to be able to see 'the wood from the trees' and it is important that preparers bear this in mind when seeking to strike the right balance between providing too much or too little information.

Q8. 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 the IASB model for MC please explain why.

We perceive that the now defunct OFR, which the Financial Reporting Council rightly upholds as a benchmark of best practice, is broadly consistent with the MC model that the project team has set out. No doubt there are aspects of detail where the UK approach differs from the proposed MC model but we are happy to leave it to other respondents to pinpoint those with greater precision than we could reasonably bring to bear.

Placement criteria

Q9. 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 report? If not, what is a more appropriate model?

We find the placement criteria described in Section 5 helpful. If applied, the criteria should lead to more consistent and more appropriate placement of information than would otherwise be the case

15 March 2006