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Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
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AUSTRALIA

Email: standard@asab.gov.au

Dear Mr Stevenson,

ED 183 - Management Commentary

We are pleased to provide comments on the AASB's *Exposure Draft 183 – Management Commentary*. Although we appreciate that the *Management Commentary* is still at an exposure draft stage our comments address key threshold issues relating to the practicalities of adopting the guidance in Australia.

AICD is the second largest member-based director association worldwide, with over 25,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, charities, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

1 Summary

AICD has long been supportive of guidance that assists directors to include clear and shareholder useful information in company annual reports. As examples, in addition to the statutory information required in annual reports, AICD has released guidance on how to produce a shareholder friendly report and how to report on underlying profit information. Despite this, AICD questions whether it is necessary to adopt guidance in the form of *ED 183 Management Commentary* given the comprehensive information already required by the Directors' Report in the Corporations Act 2001 (C'th)(the Act).

As we discuss in greater detail below, much of the content of the proposed *Management Commentary* framework must be included by Australian listed companies in their annual reports pursuant to the Act or is already covered in guidance to the ASX Listing Rules. Issuing additional guidance such as *ED 183 Management Commentary* in circumstances where that content is already mandated or comprehensively set out elsewhere, is likely to lead to confusion or to the guidance being given little weight.

Further, one of the problems faced by business which continues to be a concern for AICD is the plethora of regulation faced by companies which leads to higher transaction and compliance costs. These compliance costs increase when regulation and guidance originating from different government bodies takes a myopic approach and duplicates existing requirements. As such, AICD questions whether the AASB is the appropriate body to provide guidance on the non financial information to be included in annual reports.

In summary, our comments in respect of *ED 183 Management Commentary* are as follows:

- AICD understands that the *Management Commentary* will not become an IFRS and agrees with this approach;
- AICD has strong reservations, however, about adopting the *Management Commentary* even as guidance, given the current Australian regulatory framework; and
- in the event that, despite these concerns, the AASB decides to adopt the final form of the *Management Commentary* as guidance, AICD recommends that the AASB make clear whether the commentary is intended to apply to the Directors' Report, the review of operations and activities or to a CEO/Managing Directors' report, noting the key difference between the board and management.

A review of the existing regulatory framework in Australia provides support for AICD's views as set out above.

2 Application of Management Commentary to Not-for-Profit entities

Given that ED 183 *Management Commentary* states that it has been designed for publicly traded companies, we intend to confine our comments to the application of the *Management Commentary* to ASX listed companies. Before doing so, however, we note that the application of international standards and guidance specifically designed for listed entities but applied in Australia to public sector entities and to all reporting entities including not-for-profits and charities, will continue to be problematic.

AICD is concerned that adopting the *Management Commentary* as guidance for not-for-profit entities in particular, may add to the complexity of the reporting of non financial information for these entities. Such a move would appear to be contrary to attempts by the government to reduce the compliance and reporting burden for not-for-profit entities. In this regard we note the recent Productivity Commission review into the Contribution of the Not-for-Profit Sector and the release of the Corporations Amendment (Corporate Reporting Reform) Bill 2010. We note that the Bill proposes a new framework for, amongst other things, the preparation of Directors' Reports by companies limited by guarantee.

Unless reporting guidance fits with the requirements of the existing regulatory framework it is likely to create complexity and unwanted and unnecessary costs for not-for-profits. We now turn to the difficulties in applying the *Management Commentary* guidance to ASX listed companies.

3 Existing Requirements under the Corporations Act 2001 (C'th)

Unlike jurisdictions such as the United States where the inclusion of a 'management discussion and analysis of financial condition and results of operations' is a requirement in a listed company's annual filing, the annual report of a listed entity in Australia must include a Directors' Report. All disclosing entities, all public companies, all large proprietary companies and all registered schemes must prepare a Directors' Report.¹ The Act sets out a range of general² and specific³ information that must be included in the Directors' Report.

¹ Section 299(1) of the Act

² Section 299 of the Act and in addition, section 299A of the Act for listed companies.

³ Section 300 of the Act and in addition, section 300A of the Act for listed companies.

In addition, the Directors' Report for a financial year of a company or disclosing entity that is a listed public company, must also contain information that members of the company would reasonably require to make an informed assessment of:

- the operations of the entity reported on;
- the financial position of the entity; and
- the entity's business strategies and its prospects for future financial years.⁴

AICD notes that many of the principles and content elements of the *Management Commentary* guidance are similar to the information required by law to be included in the Directors' Report. Some examples of the information suggested by the *Management Commentary* but which are required by law to be included in an ASX listed company's annual report, are set out below.

Orientation to the future

One of the principles in the *Management Commentary* is that the commentary should have an orientation to the future. The Directors' report *must* include details of any matters since the end of the year that have significantly affected or may significantly affect, the entity's operations, the results of those operations, or the state of affairs of the entity in *future financial years*.⁵ Further, the Directors' Report must also include information that allows members to make an informed assessment of the company's *prospects for future financial years*.⁶

Strategy and Objectives

The *Management Commentary* states that the commentary should set out the entity's objectives and strategies for meeting those objectives (including a discussion of the relationship between objectives, strategy, management actions and executive remuneration). The Directors' Report *must* contain information about the entity's business strategies and its prospects for future financial years.⁷ Listed companies must also include a remuneration report as part of their Directors' report.⁸ The remuneration report requires entities to set out extensive information relating to the remuneration of key management personnel and certain executives, including any performance conditions attached to the remuneration.

Nature of business

The *Management Commentary* states that the content of the commentary should explain the nature of the business (for example, the entity's structure, industries, markets, competitive position, external environment, regulatory, legal and macro-economic environment etc.). The Directors' Report, however, requires entities to discuss their

⁴ Section 299A of the Act.

⁵ Section 299(1)(d) of the Act

⁶ Section 299A of the Act. We note that the *Management Commentary* states "the extent to which management commentary is oriented towards the future either through the use of narrative explanations or quantified data (for example, projections or forecasts) will be influenced by the regulatory and legal environment within which the entity operates." In Australia the Act does not require directors to provide financial forecasts in the annual report. The Group of 100's *Guide to the Review of Operations and Financial Condition* states that: "Overseas experience indicates that a company can provide a comprehensive and informative Review without needing to disclose financial forecasts or make other disclosures of a commercially prejudicial or sensitive nature. There is no reason to believe that Australian experience will differ from that overseas." A factor likely to foster caution in the provision of financial forecasts is the lack of a specific "safe harbour" defence in Australia for discussions of forward looking information.

⁷ Section 299A(1) of the Act

⁸ Section 300A of the Act

principal activities during the year and any significant changes in the nature of those activities during the year.⁹ Further, if the entity's operations are subject to particular and significant environmental regulation under a law of the Commonwealth, State or Territory, details of the entity's performance in relation to environmental regulation must be provided.¹⁰ As set out above, the Directors' report must also contain information that members of the company would reasonably require to make an informed assessment of the operations of the entity.¹¹

Numerous other examples could be cited of information suggested to be included by the *Management Commentary* which are already mandated by the Act. In AICD's view, issuing the IASB *Management Commentary* in an Australian context may blur the distinction between information that is suggested to be included in a company's annual report and information that is required to be included.

4 Existing Requirements under the ASX Listing Rules

In addition to the requirements of the Act, elements of the *Management Commentary* overlap with existing ASX Listing Rule guidance.

For example, ASX Listing Rule 4.10.7 provides that a listed entity must include a 'review of operations and activities for the reporting period' in its annual report.¹² The ASX does not require the review of operations and activities to follow any particular format nor does it specify its contents.¹³ ASX Guidance Note 10, however, sets out information that could be included in the 'review of operations and activities.' This Guidance Note reproduces the Group of 100 publication entitled a *Guide to the Review of Operations and Financial Condition* and by doing so incorporates this publication into its Listing rule Guidance. Elements of the *Management Commentary* overlap with, or are similar to, ASX Guidance Note 10.

The overlap continues when regard is had to the ASX Corporate Governance Council (ASXCGC), *Corporate Governance Principles and Recommendations*. ASX Listing Rule 4.10.3 provides that companies are required to provide a statement in their annual report disclosing the extent to which they have followed the Recommendations. For example, Principle 7 relates to the establishment of a sound system of risk oversight and management and internal control. This information is similar to the information suggested by the *Management Commentary* in relation to risk. However, the ASXCGC recommendations set out that the specified information must be disclosed in the company's corporate governance statement under the "if not why not" regime. If the information is not disclosed the company must explain why not. If the *Management Commentary* is reviewed in isolation entities could choose not to include information about risk and mistakenly fail to comply with the ASXCGC Corporate Governance Principles and Recommendations.

We re-iterate that the overlap between guidance that is non binding and guidance that is necessary to ensure compliance with the ASX Listing Rules may lead to confusion. Adopting another layer of guidance without alerting users to the fact that the same or similar information is mandated by law or is similar to a Listing Rule requirement, hinders rather than helps, the preparation of the annual report. Further, it may lead to the duplication of the information in different sections of the annual report.

⁹ Section 299(1)(c) of the Act

¹⁰ Section 299(1)(f) of the Act.

¹¹ Section 299A, of the Act.

¹² The notes to this Listing Rule state that it is based on section 299 of the Corporations Act.

¹³ See the Note to ASX Listing Rule 4.10.7.

For these reasons, AICD anticipates that if the final form of the *Management Commentary* guidance is adopted in Australia it will lead to confusion or to the commentary being given little weight. It is anticipated that listed companies will continue to follow the *ASXCGC Corporate Governance Principles and Recommendations* and to defer to the guidance notes accompanying the ASX Listing Rules rather than referring to the proposed IASB guidance.

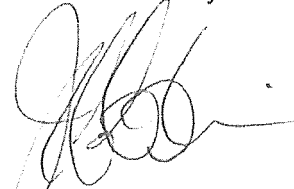
4 Management Commentary should not become an IFRS

On the basis of the existing regulatory framework AICD is strongly of the view that the *Management Commentary* should not become an IFRS and therefore supports the approach taken by the IASB that the commentary not be mandatory. However, AICD still has strong reservations about adopting the *Management Commentary* as guidance given the existing laws and regulatory guidance available in Australia.

In the event the AASB, despite AICD's concerns, decides to adopt the final form of *ED 183 Management Commentary* as guidance, AICD recommends that at the very least the application of the guidance be made clear. In other words, the AASB should specify whether the *Management Commentary* guidance is intended to assist companies in the preparation of the Directors' Report, review of operations and activities or a CEO or Managing Directors' report. This clarity is critical, given the need to avoid the duplication of information in the annual report and to ensure that the distinction between the board and management remains clear.

We hope that our comments will be of assistance to you. If you are interested in any of our views please do not hesitate to contact Leah Watterson or me on (02) 8248 6600.

Yours sincerely



John H C Colvin
Chief Executive Officer