AASB Exposure Draft

ED 183
June 2009

Management Commentary

Comments to AASB by 31 December 2009

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 31 December 2009. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 1 March 2010. Comments should be addressed to:

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@aasb.gov.au

Respondents to the IASB are asked to send their comments electronically through the 'Open to Comment' page on the IASB website (www.iasb.org)

All non-confidential submissions to the AASB will be made available to the public on the AASB website: www.aasb.gov.au.

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AASB REQUEST FOR COMMENTS

In light of the Australian Accounting Standards Board's (AASB's) policy of incorporating International Financial Reporting Standards (IFRSs) into Australian Accounting Standards, and notwithstanding that the IASB is proposing that management commentary be the subject of a guidance document and not an IFRS, the AASB is inviting comments on:

(a) any of the proposals in the attached International Accounting Standards Board (IASB) Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft ED/2009/6 *Management Commentary*; and

(b) the 'AASB Specific Matters for Comment' listed below.

The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Due Date for Comments to the AASB

Comments should be submitted to the AASB by 31 December 2009. This will enable the AASB to consider those comments in the process of formulating its own comments to the IASB which are due by 1 March 2010. Constituents are also strongly encouraged to send their response to the IASB.

AASB Specific Matters for Comment

The AASB would particularly value comments on whether:

(a) if the IASB issues a guidance document on management commentary, would a similar non-binding document have a place in Australian GAAP;

(b) there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(i) not-for-profit entities; and

(ii) public sector entities;

(c) overall, the proposals would result in financial statements that would be useful to users; and

(d) the proposals are in the best interests of the Australian economy.

June 2009

Exposure Draft ED/2009/6

Management Commentary

Comments to be received by 1 March 2010

International Accounting Standards Board®

Exposure Draft

MANAGEMENT COMMENTARY

Comments to be received by 1 March 2010

ED/2009/6

This exposure draft *Management Commentary* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments on the exposure draft should be submitted in writing so as to be received by **1 March 2010.** Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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Introduction

Summary

Management commentary provides a context within which to interpret the financial position, financial performance and cash flows of an entity. It also provides an opportunity to understand management's objectives and its strategies for achieving those objectives. Users of financial reports in their capacity as capital providers routinely use the type of information provided in management commentary as a tool for evaluating an entity's prospects and its general risks, as well as the success of management's strategies for achieving its stated objectives.

For many entities, management commentary is already an important element of their communication with the capital markets, supplementing as well as complementing the financial statements. This exposure draft presents the International Accounting Standards Board's proposals for a broad framework for the preparation and presentation of management commentary to accompany financial statements prepared in accordance with International Financial Reporting Standards (IFRSs). It is for the management of an entity to decide how best to apply this framework in the particular circumstances of its business.

How to use this document

The proposals presented in this exposure draft will not result in an IFRS. Accordingly, it would not be a requirement for an entity to comply with the framework for the preparation and presentation of management commentary as a condition for asserting compliance with IFRSs.

The Board's proposals are intended to provide a basis for the development of good management commentary. It offers a non-binding framework which could be adapted to the legal and economic circumstances of individual jurisdictions.

The exposure draft is prepared on the basis that management commentary lies within the boundaries of financial reporting and, therefore, is within the scope of the conceptual framework for financial reporting. In developing its proposals for management commentary, the Board took into account its recent work on the objective and qualitative characteristics of financial reporting.[*] Consequently, this exposure draft should be read in the context of the Phase A Framework exposure draft, published in May 2008.

[*] See the exposure draft *An improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information*, IASB (May 2008) [for brevity, referred to in this exposure draft as Phase A Framework ED].

Invitation to comment

The International Accounting Standards Board invites comments on its proposals for a type of disclosure labelled *management commentary*. The Board seeks comment on whether the framework for the preparation and presentation of management commentary proposed in the exposure draft would improve the usefulness of the information provided in an entity's financial reporting and help users of financial reports make decisions in their capacity as capital providers.

The Board invites comments on all matters addressed in this exposure draft and, in particular, on the questions set out below. Respondents need not comment on all issues and are encouraged to comment on additional issues the Board should consider. Comments are most helpful if they:

(a) respond to the issues as stated and indicate the specific paragraph or paragraphs to which the comments relate;

(b) contain a clear rationale; and

(c) include any alternative the Board should consider.

Respondents' comments will help the Board when it develops a final document on management commentary. In considering the comments, the Board will base its conclusions on the merits of the arguments for and against each alternative, not on the number of responses supporting each alternative.

Respondents should submit comments in writing so as to be received no later than **1 March 2010**.

Questions for respondents

Status of the final work product

The exposure draft proposes a framework for the preparation and presentation of management commentary. The Board believes that its proposals provide a basis for the preparation and presentation of management commentary that will be useful to the users of financial reports. However, the Board intends to publish a guidance document, not an International Financial Reporting Standard (IFRS).

Question 1

Do you agree with the Board's decision to develop a guidance document for the preparation and presentation of management commentary instead of an IFRS? If not, why?

Content elements of a decision-useful management commentary

The proposed framework for the preparation and presentation of management commentary is intentionally general. This reflects the Board's view that a flexible approach elicits more meaningful disclosure by encouraging entities that choose to prepare management commentary to discuss those matters most relevant to their individual circumstances. Consequently, the proposed framework for the preparation and presentation of management commentary sets out the principles, qualitative characteristics and content elements necessary to provide existing and potential capital providers with decision-useful information.

Question 2

Do you agree that the content elements described in paragraphs 24–39 are necessary for the preparation of a decision-useful management commentary? If not, how should those content elements be changed to provide decision-useful information to users of financial reports?

Application guidance and illustrative examples

The Board does not intend to include application guidance or illustrative examples in the final management commentary guidance document. The Board is concerned that such detailed guidance could be interpreted as either a floor (minimum requirements for content) or a ceiling (the only disclosures for inclusion in management commentary). The Board believes that the development of application guidance or illustrative examples to help management apply the proposed framework for management commentary is best left to other organisations.

Question 3

Do you agree with the Board's decision not to include detailed application guidance and illustrative examples in the final management commentary guidance document? If not, what specific guidance would you include and why?

[Draft] *Management Commentary*

Objective

1 **This guidance prescribes a framework for the preparation and presentation of management commentary to assist management in preparing decision-useful management commentary to accompany financial statements prepared in accordance with International Financial Reporting Standards (IFRSs).**

2 Management commentary prepared in accordance with this framework can provide users of the financial statements with historical and prospective commentary on the entity's financial position, financial performance and cash flows, and a context for understanding management's objectives and its strategies for achieving those objectives.

3 Management commentary prepared in accordance with this framework is within the boundaries of financial reporting and, therefore, is within the scope of the conceptual framework for financial reporting.*

Scope

4 [Draft] *Management Commentary* (Guidance) has been developed to apply to publicly traded entities. However, it does not mandate which entities should be required to publish management commentary, how frequently an entity should do so or the level of assurance to which management commentary should be subjected.

5 Governments, securities regulators, stock exchanges and accountancy bodies often require entities whose debt or equity securities are publicly traded to publish management commentary. Management commentary encompasses reporting that is described in various jurisdictions as management's discussion and analysis (MD&A), operating and financial review (OFR), or management's report.

* This exposure draft is prepared in the light of the Board's recent thinking on the objectives of financial reporting and the qualitative characteristics and constraints of decision-useful financial reporting information [referred to in this exposure draft as Phase A Framework ED]. The Board expects to finalise its proposals on those topics and publish the first chapter of the Conceptual Framework for Financial Reporting in Q3 2009.

Identification of management commentary

6 When an entity prepares management commentary to accompany IFRS financial statements, it should not make that commentary available without those financial statements.

7 Management should identify clearly what it is presenting as management commentary and distinguish it from other information in the same financial report.

Framework for the preparation and presentation of management commentary

8 An entity's management should apply paragraphs 9–39 when preparing management commentary to accompany financial statements prepared in accordance with IFRSs.

Users

9 The needs of existing and potential capital providers, as the primary users of the financial reports, are paramount when management considers what information to include in management commentary.[*]

Time frame

10 Management commentary should communicate information about an entity's economic resources, claims on those resources and the transactions and other events and circumstances that change them.[†] It also should explain the main trends and factors that are likely to affect the entity's future performance, position and development. Consequently, management commentary looks not only at the present, but also at the past and the future.

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* From *Objective of general purpose financial reporting*, Phase A Framework ED, paragraph OB2.

† From *Information about an entity's resources, claims on those resources and changes in resources and claims*, Phase A Framework ED, paragraphs OB15–OB25.

Purpose

11 Management commentary prepared in accordance with this framework should provide existing and potential capital providers with information that helps them place the related financial statements in context. Management commentary that fulfils that purpose explains management's view on not only what has happened, but also why management believes it has happened and what management believes the implications are for the entity's future.

Principles for the preparation of management commentary

12 Management commentary prepared in accordance with this framework can help users of the financial reports assess the performance of the entity and the actions of its management relative to stated strategies and plans for development. That type of commentary may help users of the financial reports to understand, for example:

(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 operations; and

(c) how non-financial factors have influenced the information presented in the financial statements.

13 In developing its commentary, management should bear in mind the principles that underpin decision-useful management commentary. Commentary that is aligned with those principles:

(a) provides management's view of the entity's performance, position and development;

(b) supplements and complements information presented in the financial statements; and

(c) has an orientation to the future.

Management's view

14 Management has a unique perspective on the entity. That perspective has value for users of financial reports. Generally, the information that is important to management in managing the business is the same information that is important to users of the financial reports for assessing financial performance and prospects.

Supplement and complement the financial statement information

15 In supplementing financial statements, management commentary includes additional explanations of amounts presented in the financial statements and explains the conditions and events that shaped that information.

16 In complementing financial statements, management commentary includes financial and non-financial information about the entity and its performance that is not presented in the financial statements.

Orientation to the future

17 Having an orientation to the future is about communicating, from management's perspective, the direction the entity is taking. For example, management can provide useful information to users of the financial reports by setting out its objectives for the entity and its strategies for achieving those objectives. 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. Information with an orientation to the future is described in this document as *forward-looking information*.

18 Management should include forward-looking information when management is aware of trends, uncertainties or other factors that could affect the entity's liquidity, capital resources, revenues and results of operations. Forward-looking information is useful when it focuses on the extent to which the entity's performance is indicative of future results and includes management's assessment of the entity's prospects in the light of that performance.

19 Management should discuss the extent to which forward-looking disclosures made in the prior period management commentary have been borne out. That discussion should explain how and why the performance of the entity is short of, meets or exceeds the

forward-looking disclosures made in the previous management commentary. For example, if management stated targets for future performance in previous reporting periods, it should report the entity's actual performance in the current reporting period and analyse and explain significant variances from its previously stated targets as well as the implications of those variances for management's expectations for the entity's future performance.

Qualitative characteristics of decision-useful information and constraints on financial reporting

20 The degree to which the information in management commentary is useful depends on that information's qualitative characteristics. To be useful, information in the financial reports must possess the fundamental qualitative characteristics of *relevance* and *faithful representation*.[*] The enhancing qualitative characteristics of *comparability, verifiability, timeliness* and *understandability* should be maximised.[†] Two pervasive constraints limit the information provided by management commentary: materiality and cost.[§]

Presentation

21 The form of management commentary will vary between entities, reflecting the nature of their business, the strategies adopted by management and the regulatory environment in which they operate.

22 Management commentary, like other disclosures, should be clear and straightforward. Reciting financial statement information without analysis or presenting boilerplate discussions that do not provide insight into the entity's past performance or prospects as understood by management is unlikely to provide information that is useful to users of the financial reports.

23 Management commentary should be presented with a focus on the most important information, in a manner intended to address the principles described in this [draft] Guidance. Specifically:

(a) Management commentary should be consistent with its related financial statements. If the financial statements include segment

* From *Fundamental qualitative characteristics*, Phase A Framework ED, paragraphs QC2–QCB11.

† From *Enhancing qualitative characteristics*, Phase A Framework ED, paragraphs QC15–QCB24.

§ From *Constraints on financial reporting*, Phase A Framework ED, paragraph QC27–QC33.

information, the information presented in the management commentary should reflect that segmentation.

(b) Management should avoid duplicating in its management commentary the disclosures made in the notes to its financial statements. Doing so may create an obstacle for users to identify and understand the most significant matters facing the entity. Generic disclosures that do not relate to the practices and circumstances of the entity should also be avoided.

Content elements of a decision-useful management commentary

24 Although the relevant focus of management commentary will depend on the facts and circumstances of the entity, a decision-useful management commentary includes information that is essential to an understanding of:

(a) the nature of the business;

(b) management's objectives and strategies for meeting those objectives;

(c) the entity's most significant resources, risks and relationships;

(d) the results of operations and prospects; and

(e) the critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives.

25 The content elements are related and should not be presented in isolation. Management's perspective on the business and its analysis of the interaction of the content elements helps users understand the entity's financial statements as well as management's objectives and strategies for achieving those objectives.

Nature of the business

26 A description of the business helps users of the financial reports gain an understanding of the entity and the external environment in which it operates. That information serves as a starting point for assessing and understanding an entity's performance, strategic options and prospects. Depending on the nature of the business, management commentary may include discussion of matters such as:

(a) the industries in which the entity operates;

(b) the entity's main markets and competitive position within those markets;

(c) significant features of the legal, regulatory and macro-economic environment that influence the entity and the markets in which the entity operates;

(d) the entity's main products and services, business processes and distribution methods; and

(e) the entity's structure and its economic model.

Objectives and strategies

27 Disclosure of objectives and strategies are most useful when they enable users of the financial reports to understand the priorities for action as well as the resources that must be managed to deliver results. Management's explanations about how success will be measured and over what period of time it should be assessed may also be useful. For example, how management intends to address market trends and the threats and opportunities those market trends represent provides users of the financial reports with insight that may shape their expectations about the entity's future performance. Discussion of the relationship between objectives, strategy, management actions and executive remuneration is also helpful.

Resources, risks and relationships

28 Management commentary that includes a clear description of the most important resources, risks and relationships that management believes affect the entity's long-term value and how those resources, risks and relationships are managed provides useful information for users of the financial reports.

Resources

29 Disclosure about resources depends on the nature of the entity and the industry in which the entity operates. Management commentary should set out the critical financial and non-financial resources available to the entity and how those resources are used in meeting management's stated objectives for the entity. Analysis of the adequacy of the entity's capital

structure, financial arrangements (whether or not recognised in the statement of financial position), liquidity and cash flows, as well as plans to address any identified inadequacies or surplus resources, are examples of disclosures that can provide useful information.

Risks

30 Disclosure of an entity's principal risk exposures, its plans and strategies for bearing or mitigating those risks, and the effectiveness of its risk management strategies, helps users to evaluate the entity's risks as well as its expected outcomes. It is important that management distinguish the principal risks and uncertainties facing the entity, rather than listing all possible risks and uncertainties.

31 Management should disclose its principal strategic, commercial, operational and financial risks, being those that may significantly affect the entity's strategies and development of the entity's value. The description of the principal risks facing the entity should cover both exposures to negative consequences and potential opportunities. Management commentary provides useful information when it discusses the principal risks and uncertainties necessary to understand management's objectives and strategies for the entity—both when they constitute a significant external risk to the entity and when the entity's impact on other parties through its activities, products or services affects its performance.

Relationships

32 Management provides information useful to users of the financial reports when it identifies the significant relationships the entity has with stakeholders, how those relationships are likely to affect the performance and value of the entity, and how those relationships are managed. This type of disclosure helps users of the financial reports to understand, for example, whether a single customer, or a small group of principal customers, represents a significant portion of an entity's business and whether that entity and its investors may be exposed to substantial risk if that customer takes its business to a competitor.

Results and prospects

33 Management commentary should include a clear description of the entity's financial and non-financial performance, the extent to which that performance may be indicative of future performance and management's assessment of the entity's prospects. Useful disclosure in that area can help users to make their own assessments about the assumptions and judgements used by management in preparing the financial statements.

Results

34 Explanations of the performance and development of the entity during the period and its position at the end of that period provide users of the financial reports with insight into the main trends and factors affecting the business. Those explanations are useful when they describe the relationship between the entity's results, management's objectives and management's strategies for achieving those objectives. Discussion and analysis of significant changes in financial position, liquidity and performance compared with those of the previous period(s) can help users to understand the extent to which past performance may be indicative of future performance.

Prospects

35 An analysis of the prospects of the entity, including targets for financial and non-financial measures, helps users of the financial reports to understand how management intends to implement its strategies for the entity over the long term. When targets are quantified, management should explain the risks and assumptions necessary for users to assess the likelihood of achieving those targets.

Performance measures and indicators

36 The disclosure of performance measures and indicators (both financial and non-financial) that are used by management to assess progress against its stated objectives can help users of the financial reports assess the degree to which goals and objectives are being achieved. Performance measures are quantified measurements that reflect the critical success factors of an entity. Indicators can be narrative evidence describing how the business is managed or quantified measures that provide indirect evidence of performance.

37 The performance measures and indicators that are most important to understanding an entity are those that management uses to manage that entity. The performance measures and indicators will usually reflect the industry in which the entity operates. Comparability is enhanced if the performance measures and indicators are accepted and used widely, either within an industry or more generally.

38 Consistent reporting of performance measures and indicators increases the comparability of management commentary over time. However, management should consider whether the performance measures and indicators used in the previous period continue to be relevant. As strategies and objectives change, management might decide that the performance measures and indicators presented in the previous period management commentary are no longer relevant. When management changes the performance measures and indicators used, the changes should be identified and explained.

39 If information from the financial statements has been adjusted for inclusion in management commentary, that fact should be disclosed. If financial performance measures that are not required or defined by IFRSs are included within management commentary, those measures should be defined and explained and, when possible, reconciled to measures presented in the financial statements.

Appendix
Defined terms

This appendix is an integral part of [draft] Management Commentary.

comparability[*]	The quality of information that enables users to identify similarities in and differences between two sets of economic phenomena.
economic phenomena[*]	Economic resources, claims on those resources, and the transactions and other events and circumstances that change them.
faithful representation[*]	The correspondence or agreement between the accounting measures or descriptions in financial reports and the economic phenomena they purport to represent. Faithful representation is attained when the depiction of an economic phenomenon is complete, neutral and free from material error.
forward-looking information	Information about the future. It includes information about the future that might subsequently be prepared as historical information. It is subjective and its preparation requires the exercise of professional judgement.
management	Persons responsible for the decision-making and oversight of the entity. This may include executive employees and members of a governing body.[†]
management commentary	A narrative report accompanying financial statements prepared in accordance with IFRSs that provides users with historical and prospective commentary on the entity's financial position, financial performance and cash flows, and a basis for understanding management's objectives and its strategies for achieving those objectives.

[*] These definitions are taken from the Phase A Framework ED, published May 2008.

[†] See paragraphs BC24 and BC25 for additional information.

relevance*	A quality of information that makes it capable of making a difference in the decisions made by users in their capacity as capital providers. Information about an economic phenomenon is capable of making a difference when it has predictive value, confirmatory value or both.
timeliness*	Having information available to decision-makers before it loses its capacity to influence decisions.
understandability*	The quality of information that enables users to comprehend its meaning.
verifiability*	A quality of information that helps assure users that information faithfully represents the economic phenomena that it purports to represent.

* These definitions are taken from the Phase A Framework ED, published May 2008.

Approval by the Board of *Management Commentary* published in June 2009

The exposure draft *Management Commentary* was approved for publication by eleven of the fourteen members of the International Accounting Standards Board. Messrs Garnett, Kalavacherla and Leisenring voted against publication of the exposure draft. Their alternative views on the exposure draft are set out after the Basis for Conclusions.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Stephen Cooper	
Philippe Danjou	
Jan Engström	
Robert P Garnett	
Gilbert Gélard	
Prabhakar Kalavacherla	
James J Leisenring	
Warren J McGregor	
John T Smith	
Tatsumi Yamada	
Wei-Guo Zhang	

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, draft Management Commentary*.*

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standard Board's considerations in developing the proposals in the exposure draft *Management Commentary* (Guidance). Individual Board members gave greater weight to some factors than to others.

BC2 The purpose of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions.[*] Financial statements prepared for that purpose meet the common needs of most users. However, financial statements do not provide all the information that users need to make economic decisions because the financial statements largely portray the financial effects of past events and do not provide non-financial indicators of future performance.[†]

BC3 The purpose of the proposed Guidance is to establish a framework to guide the preparation and presentation of information in management commentary as a companion to the financial statements. The proposed Guidance is intended to affect how management communicates information on its performance, objectives and strategies to users of the financial reports. The Board's goal is to improve the usefulness of the information provided in an entity's management commentary so that, when used in conjunction with the financial statements, users are better able to make decisions in their capacity as capital providers.

* IAS 1 *Presentation of Financial Statements*, paragraph 9.

† For example, IFRSs do not cover intangible assets such as human capital and processes. Economic resources not captured in the financial statements may constitute a significant source of value for the entity.

Background

BC4 In late 2002 the Board set up a project team comprising representatives from the national standard-setters in Canada, Germany, New Zealand and the United Kingdom to examine the potential for issuing a standard or guidance on management commentary. In October 2005 the Board published the results of the project team's research in a discussion paper *Management Commentary*.

BC5 In the discussion paper, the project team presented its views on the users, objective and qualitative characteristics of management commentary. The project team also described essential content elements of management commentary and a possible framework for use by standard-setters in distinguishing between information that would appear in management commentary and information that would appear in the notes to the financial statements.

BC6 The Board developed the exposure draft after considering the proposals contained in the discussion paper and respondents' comments on those proposals; developments in narrative reporting at the regulatory level in a variety of local and regional jurisdictions; and the Board's recent work (Phase A Framework ED) on the objectives and qualitative characteristics of financial reporting in its joint project with the US Financial Accounting Standards Board (FASB) to improve the conceptual framework.

Proposals

BC7 The following paragraphs summarise the Board's rationale for its proposals for:

(a) the scope of the proposed guidance (paragraphs BC8–BC11);

(b) identification of management commentary (paragraphs BC12–BC14);

(c) the users of management commentary (paragraphs BC15–BC18);

(d) the time frame covered by management commentary (paragraphs BC19 and BC20);

(e) the purpose of management commentary (paragraph BC21);

(f) principles for the preparation of management commentary (paragraphs BC22–BC33);

(g) presentation (paragraphs BC34–BC40); and

(h) content elements of a decision-useful management commentary (paragraphs BC41–BC43).

Scope

BC8 The Board considered whether the Guidance, when finalised, should be issued as an International Financial Reporting Standard (IFRS) or published as a guidance document distinct from IFRSs. In the light of feedback received from respondents to the discussion paper, the Board decided that the final product should be a guidance document rather than an IFRS.

BC9 The Board's proposals for a framework to guide the preparation and presentation of management commentary are meant to foster good practice in management commentary reporting by permitting an entity's management to exercise discretion in tailoring its commentary to the entity's particular circumstances. The Board noted that both the Committee of European Securities Regulators (CESR) and the International Organization of Securities Commissions (IOSCO) support the publication of a guidance document on management commentary. The Board also noted that a similar regime exists in the United Kingdom, where a Reporting Statement on Operating and Financial Reviews (OFRs) was published by the UK Accounting Standards Board (ASB) in January 2006.

BC10 The Board's decision to develop its proposals for a framework to guide the preparation and presentation of management commentary in the form of a guidance document rather than an IFRS enables individual jurisdictions to make their own judgements on:

(a) whether entities should be required to include management commentary in their financial reports to assert compliance with IFRS financial statements;

(b) the level of assurance to which management commentary should be subjected;

(c) the necessity for 'safe harbour' provisions in relation to the inclusion of forward-looking information;* and

(d) the type of entity that should prepare management commentary.

BC11 In some jurisdictions, some entities are accustomed to preparing management commentary-type reports because of local requirements or regulations imposed by the public exchanges on which their securities are listed. The Guidance published by the Board could prove useful to other entities. Also, it could promote comparability across all entities that prepare management commentary to accompany their IFRS financial statements, thereby improving the usefulness of the financial reports to users. The existence of IASB guidance may also encourage regulators to adopt it as their own.

Identification of management commentary

BC12 The proposed Guidance applies only to management commentary and not to other information presented in either the financial statements or the broader financial reports. IAS 1 *Presentation of Financial Statements* sets out requirements for the presentation of disclosures in the statement of financial position, the statement of comprehensive income and the statement of changes in equity. IAS 7 *Statement of Cash Flows* sets out requirements for the presentation of cash flow information. Additionally, each IFRS sets out disclosure requirements relevant to its subject matter.

BC13 The Board observed that it is important that users of the financial reports should be able to distinguish information that is prepared using the proposed Guidance from information that is prepared using IFRSs, and from information that may be useful to users but is not the subject of the guidance described in the Guidance or the requirements in IFRSs.

BC14 The proposed Guidance is a non-binding framework for the preparation and presentation of management commentary. Consequently, the Board decided that preparers should not be expected to include in the financial reports any formal confirmation that they have complied with the framework set out in the Guidance. However, the Board noted that including some comment on the extent to which the Guidance has been followed may be helpful to the users of the financial reports.

* A safe harbour is a provision of a statute or a regulation that reduces or eliminates a party's liability under the law, on the condition that the party performed its actions in good faith. Legislators include safe harbour provisions to protect legitimate or excusable violations.

Users of management commentary

BC15 In July 2008 the Board revisited the conclusions of the discussion paper in the light of its revised thinking for Phase A of the conceptual framework project. The Board's approach to management commentary is based on the principle that a framework for management commentary should be consistent with the conceptual framework for financial reporting. That decision affected two aspects of the proposed Guidance: the users and the qualitative characteristics (see paragraphs BC31–BC33) of management commentary.

BC16 The discussion paper identified investors as the primary users of management commentary. In most jurisdictions, the users of management commentary are confined to investors, or a narrower group such as current shareholders. In some jurisdictions there has been debate about which users should be the focus of management commentary—with many constituents taking the view that management commentary should meet the needs of all stakeholders.

BC17 The Phase A Framework ED identifies existing and potential capital providers as the primary users of financial reports. The primary user group therefore includes both existing and potential equity investors, lenders and other creditors, regardless of how they obtained, or will obtain, their interests. The information provided by the financial reports focuses on the needs of all capital providers, not just the needs of a particular group.

BC18 The Board noted that if management commentary is expected to provide context for a set of financial statements, it follows that the primary users of each component of the financial reports should be the same. Consequently, the focus of management commentary in the exposure draft reflects existing and potential capital providers as its primary users.

Time frame covered by management commentary

BC19 The Board observed that even though an entity's management commentary relates to a set of financial statements covering a particular reporting period, the content of that management commentary is not necessarily bound to the reporting period described by the financial statements. An important principle underpinning the information provided within management commentary is that it has an orientation to the future. The Board concluded that the inclusion of forward-looking information within management commentary helps users of the financial reports assess whether past performance is indicative of future performance and whether the development of the entity is in line with management's stated objectives.

BC20 The term 'development' is used to reflect how the entity has grown or changed in the current year, as well as how it expects to grow or change in the future. That usage stems from the European Union's requirement for 'at least a fair review of the development of the company's business and of its position.'[*]

Purpose of management commentary

BC21 In determining the purpose for management commentary, the Board looked to the objectives stated in existing regulations and guidance. Guidance issued by the US Securities and Exchange Commission (SEC) in December 2003 states that the purpose of Management's Discussion and Analysis (MD&A) is 'not complicated.' It is to provide readers with information 'necessary to an understanding of [a company's] financial condition, changes in financial condition and results of operations.'[†] Put simply, the purpose of management commentary is to provide, from management's view, context for the financial statements.

Principles for the preparation of management commentary

Management's view

BC22 The principle of management's view has its roots in regulation, specifically in the MD&A requirements of the SEC. The first of the SEC objectives for MD&A reporting is:

> ... to provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management.[†]

That requirement has also been enshrined in securities regulation in Canada, and appears as the first principle in the United Kingdom's Reporting Statement on the Operating and Financial Review (OFR).

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* EU, Article 46 of the Fourth Directive.

† SEC, Regulation S–K, Item 303.

BC23 Research undertaken by PricewaterhouseCoopers (PwC) that involved more than 3,100 participants across fourteen countries and sixteen industries suggests that users' needs are also consistent with the principle of management's view. The PwC research suggests that, with few exceptions, the information important to management in managing the business is the same information that is important to capital providers in assessing performance and prospects.[*]

BC24 This principle raises the issue of what is meant by 'management.' IFRS 7 *Financial Instruments: Disclosures* uses the term 'key management personnel' as defined in IAS 24 *Related Party Disclosures*, meaning 'those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.'[†]

BC25 The Board noted that determining who prepares and approves management commentary is likely to depend on jurisdictional requirements. For example, in the United Kingdom, the Companies Act 2006 requires a business review as part of the directors' report. For quoted companies, the requirements are reflected in the UK ASB's OFR Reporting Statement, which recommends an OFR to be the analysis of the directors. Furthermore, it is the directors who are responsible for approving the business review/OFR. There are similar requirements in Canada, France and Germany.

Supplement and complement the financial statements

BC26 The Board noted that the principle of providing information to supplement and complement the financial statements in effect formalises a statement in the *Preface to International Financial Reporting Standards*, namely that:

> Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions.[§]

BC27 The Board observed that management commentary meets the definition of 'other financial reporting' described in the *Preface*.

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* PwC Trends 2005.

† IAS 24, paragraph 9.

§ *Preface*, paragraph 7.

Orientation to the future

BC28 The requirement for a focus on information that helps users of the financial reports assess prospects is found in all of the jurisdictions surveyed in the discussion paper. This principle has its roots in regulation, specifically in the MD&A requirements of the SEC. The third of the SEC objectives for MD&A reporting is:

> … to provide information about the quality of, and potential variability of, a company's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.*

BC29 This US regulatory requirement for the inclusion of information that helps investors assess prospects is found in both Canadian securities regulations and the European Modernisation Directive. The Directive has in turn been transposed into legislation in EU Member States.

BC30 The Board observed that how, and the extent to which, management commentary is oriented towards the future will be influenced by the regulatory and legal environment within which the entity operates. Explanations of past events can help users of the financial reports develop expectations about the entity from its past performance and current state. Although disclosure of forward-looking information is encouraged in many jurisdictions, this does not necessarily mean forecasts or projections. In some jurisdictions there are safe harbour provisions to restrict liability claims or regulatory provisions, or both, that require cautionary statements relating to forward-looking information.

Qualitative characteristics

BC31 Given that management commentary supplements and complements the financial statements, the discussion paper proposed that management commentary should be expected to meet, as much as possible, qualitative standards similar to those applicable to the financial statements. At the time when the discussion paper was being drafted, the conceptual framework for financial statements described four qualitative characteristics: *relevance, understandability, reliability* and *comparability*. Rather than using the qualitative characteristics of *reliability* and *comparability*, the discussion paper proposed the use of *supportability*, *balance* and *comparability over time* as being more relevant to management commentary.

* SEC, Regulation S–K, Item 303.

BC32 The Board observed that its work on Phase A of the conceptual framework applies to the broader financial reports, not just financial statements. When the Board decided that management commentary was within the boundaries of financial reporting and within the scope of the conceptual framework, it also decided that it would be inconsistent to develop qualitative characteristics that are specific to management commentary. Furthermore, the Board decided that it should resolve questions about the applicability of the qualitative characteristics to management commentary in Phase A of the conceptual framework project, not in the management commentary project.

BC33 Consequently, the exposure draft refers to the qualitative characteristics described in the Phase A Framework ED but does not contain application guidance for those qualitative characteristics to management commentary. Questions about the applicability of the qualitative characteristics to management commentary will be resolved during the finalisation of Chapter 1 of the Conceptual Framework for Financial Reporting, the subject of which is the objective of financial reporting and the qualitative characteristics and constraints of decision-useful information.

Presentation

BC34 The Board considered the following three aspects of presentation when developing its proposals for management commentary:

(a) presentation of information within management commentary;

(b) presentation of management commentary in relation to the financial statements (ie positioning); and

(c) presentation of disclosure within the financial reports.

Presentation of information within management commentary

BC35 The discussion paper proposed that it is management's responsibility to decide both the content of its management commentary and the best way to present that content. Providing flexibility in both the content and presentation of management commentary reduces the risk that constituents will adopt a boilerplate approach to their preparation of management commentary.

BC36 Although the exposure draft maintains the premise that management is best positioned to determine the presentation of management commentary, the Board decided to formalise its intention that management commentary should be consistent with the financial statements, particularly in terms of its presentation of segment information. The Board noted that, if the financial statements include segment information, the information presented in the management commentary should reflect that segmentation.

Positioning of management commentary relative to the financial statements

BC37 The positioning of management commentary relative to the financial statements varies across jurisdictions that require management commentary-type reporting. In some jurisdictions, management commentary accompanies the annual financial statements in a printed report to shareholders; in other jurisdictions, management commentary is contained within separate annual regulatory filings.

BC38 The Board considered whether it would be desirable to incorporate management commentary within the financial statements, perhaps by adding textual material and other information within the notes to the financial statements. The Board rejected this idea on the ground that management commentary should supplement and complement the financial statements. Consequently, management commentary should be part of a financial report that includes the financial statements and not be placed within the financial statements.

BC39 The Board also decided to link management commentary to the financial statements as a stand-alone document. Again, management commentary is designed to supplement and complement information provided in a related set of financial statements. Consequently, when management commentary is prepared to accompany IFRS financial statements, it should not be made available for use without those IFRS financial statements. Conversely, IFRS financial statements can be made available for use without a corresponding management commentary.

Presentation of disclosure within the financial reports

BC40 In October 2008 the IASB and the FASB published a discussion paper *Preliminary Views on Financial Statement Presentation*. That discussion paper is centred on resolving presentation issues within the primary financial statements. Financial information included in the notes to the financial statements and management commentary that may accompany the financial statements is outside the scope of the financial statement presentation project. Consequently, the Board has not considered whether its proposals for financial statement presentation may be extended to include disclosure within management commentary.

Content elements of a decision-useful management commentary

BC41 The Board noted that specifying disclosures for management commentary may be more difficult than specifying information to be disclosed in the notes to the financial statements. The types of activities that are critical to an entity are specific to that entity. As a consequence, regulators have tended to identify the elements that reflect the type of content they expect to see in management commentary rather than defining the elements themselves. Specifying a detailed list also encourages a checklist compliance mentality, which the Board wishes to avoid.

User needs

BC42 The five content elements described in paragraphs 24–39 are based on the needs of capital providers as the primary users of management commentary information. The table below relates the five content elements to the needs of capital providers when using management commentary to assess an entity's performance and make financial decisions.

Content elements	**User needs**
Nature of the business	The knowledge of the business in which an entity is engaged and the external environment in which it operates.
Objectives and strategies	To assess the strategies adopted by the entity and the likelihood that those strategies will be successful in meeting management's stated objectives.
	continued...

continued...	
Content elements	**User needs**
Resources, risks and relationships	A basis for determining the resources available to the entity as well as obligations to transfer resources to others; the ability of the entity to generate long-term, sustainable net inflows of resources; and the risks to which those resource-generating activities are exposed, both in the near term and in the long term.
Results and prospects	The ability to understand whether an entity has delivered results in line with expectations and, implicitly, how well management has understood the entity's market, executed its strategy and managed the entity's resources, risks and relationships.
Performance measures and indicators	The ability to focus on the critical performance measures and indicators that management uses to assess and manage the entity's performance against stated objectives and strategies.

BC43 The Board also observed that information in management commentary will be of interest to users other than capital providers. As a result, management may need to consider the extent to which commenting on issues relevant to a wider user group may be appropriate given the degree of those issues' influence on the performance of the entity and its value. The Board noted that management commentary should not, however, be seen as a replacement for other forms of reporting addressed to a wider stakeholder group.

Placement of disclosure within the financial reports

BC44 The Board noted that, currently, neither IFRSs nor the conceptual framework includes principles to inform the Board's approach for establishing disclosure requirements. One question raised by constituents centres on determining the appropriate location for disclosure—does the information belong in the notes to the financial statements or does it belong in management commentary? The discussion paper included proposals for a framework to aid the Board in determining where in the financial reports disclosures are most appropriately presented.

BC45 In December 2007 the Board decided to defer its work on a framework for disclosure to Phase E of the conceptual framework project. The Board noted that Phase E of the conceptual framework includes the development of disclosure principles. Consequently, the Board views Phase E of the conceptual framework as the appropriate project to resolve questions about the placement of disclosures in the financial reports.

BC46 The Board acknowledges that until Phase E of the conceptual framework is completed, overlap will exist between the type of information that is disclosed in the notes to the financial statements and that which is disclosed in management commentary. In the light of that overlap, the Board determined it was more important to establish management commentary as a disclosure tool within IFRSs than it was to immediately resolve questions of placement for that information.

Application guidance and illustrative examples

BC47 The discussion paper contains both application guidance and illustrative examples that are included to demonstrate the principles underpinning the management commentary framework.

BC48 The Board decided not to include application guidance or illustrative examples in the exposure draft for two primary reasons. First, the Board noted the risk that its application guidance or illustrative examples could be interpreted as either a floor (minimum requirements) or a ceiling (the only disclosures for inclusion in management commentary). Consequently, the Board decided that the risk of undue emphasis being placed on the application guidance and illustrative examples outweighs their utility. Second, the Board decided that the development of application guidance or illustrative examples to help entities apply the framework for the preparation and presentation of management commentary is best left to other organisations.

Alternative views on exposure draft

Alternative views of Robert P Garnett, Prabhakar Kalavacherla and James J Leisenring

AV1 Messrs Garnett, Kalavacherla and Leisenring voted against publication of this exposure draft for the reasons set out below.

AV2 The proposals in the exposure draft, if finalised, will result in non-authoritative guidance that constituents can choose to follow or to ignore. Consequently, these Board members do not believe that the proposed guidance document will result in improvements in financial reporting.

AV3 These Board members believe that management commentary cannot satisfy the requirements of neutrality as defined in the Phase A Framework exposure draft.* That exposure draft defines neutrality as the absence of bias intended to attain a predetermined result or to induce a particular behaviour. These Board members observe that management commentary represents, by definition, management's view of the entity.

AV4 These Board members also believe that, because the proposals in this exposure draft will not result in an IFRS, following the same due process as is required for an IFRS is an effective use of neither IASB resources nor the resources of constituents who will feel some obligation to respond.

AV5 Mr Kalavacherla believes that the proposals in the exposure draft related to forward-looking information cannot be put into operation without application guidance. He believes that the omission of application guidance for forward-looking information could result in management commentary information that is misleading and thus not helpful to the users of financial reports.

* See the exposure draft *An improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision–useful Financial Reporting Information*, IASB (May 2008) [for brevity, referred to in this exposure draft as Phase A Framework ED].

