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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: 25 January 2007, London

Project: Management Commentary

Subject: Letter from Management Commentary Project Team re
Preliminary views on an improved Conceptual Framework
for Financial Reporting (Agenda paper 11C)

**Management Commentary (MC) project team
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3 November 2006

Dear Li Li,

Preliminary Views on an improved Conceptual Framework for Financial Reporting

We write in our capacity as members of the Management Commentary (MC) discussion paper project team. We have included our job titles and employers at the end of this letter by way of identification, but it should be clear that we are writing in our personal capacities and not on behalf of our employers.

We are responding to the consultation in the light of our own experience of developing the MC discussion paper as well as the insights provided by 117¹ responses to our discussion paper. The relationship between the MC project and the Conceptual Framework project is evident from comments made by a number of respondents to our MC discussion paper. Appendix A provides some example comments made by respondents with regard to financial reporting. Appendix B sets out specific references made to the conceptual framework project in the analysed comment letters.

In particular, we believe there are four areas where our experience and the views of respondents to the MC discussion paper provide useful observations for the Conceptual Framework project. These are:

- What constitutes financial reporting?
- Who are the primary users of financial reports assumed to be?

¹ The analysis provided in this paper is based on 116 responses. Respondent 117 was a late submission and while acknowledging that the project is the most significant task facing the international business community it did not answer the specific questions in our discussion paper.

- Can the same qualitative characteristics be applied to all components of financial reports?
- Should placement criteria be developed?

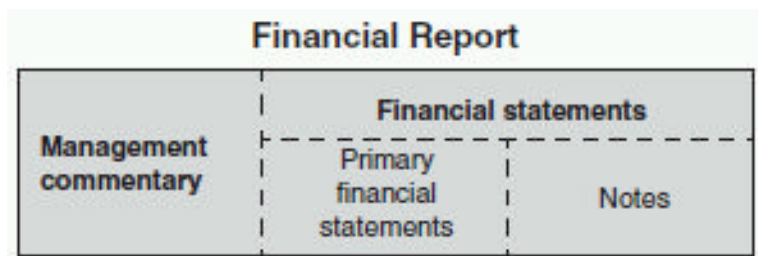
What constitutes financial reporting?

The July 2006 Conceptual Framework discussion paper does not define what is meant by a ‘financial report’. As stated in the discussion paper, the Boards have concluded that:

‘... consideration of specific issues concerning the boundaries of financial reporting and distinctions between financial statements and other parts of financial reporting should be deferred to a later phase of the conceptual framework project.’

Our experience is that formulating the boundaries of financial reporting as well as defining what is meant by a key component of financial reporting such as MC, was an essential first step in determining the users, objective and qualitative characteristics of Management Commentary.

In our discussion paper we concluded that financial reports consisted of financial statements, being primary financial statements and notes, along with MC, as set out in Figure 1.1 of our paper, and copied below:



Of the 116 comment letters analysed, 104 (92%) of the respondents agreed that management commentary is an integral part of financial reporting. Those who disagreed with the view that MC was integral to financial reporting primarily did so due to concerns over MC audit requirements. As noted earlier, Appendix A provides some example comments made by respondents with regard to financial reporting.

However, we did not explicitly consider whether financial reporting would have any further key components. As indicated in the Conceptual Framework discussion paper in paragraphs OB16 and BC1.7, financial reporting could encompass a number of components ranging from corporate annual reports, news releases, management’s forecasts to compliance with environmental regulation. While we did not explicitly consider whether there were other key components of financial reporting, in our consideration of the users of MC we concluded:

‘..., MC should not be seen as a replacement for other forms of reporting addressed to a wider stakeholder group. For example, sustainability and corporate social responsibility reports are prepared by many companies nowadays and are aimed at the needs of a broad class of stakeholder.’ (para 30)

In conclusion, it is our view that without the boundaries of financial reporting being defined, and without a common understanding of who are the users of financial reporting, it is difficult to ensure congruence between the objective of such reporting and the information set provided.

Who are the primary users of financial reports assumed to be?

In our MC discussion paper we concluded that the appropriate focus of MC was on investors as set out below:

‘In our view, the information provided by MC should focus on meeting the needs of investors. It should not be expanded to fulfil the information needs of an extended range of users.’ (para 30)

The results of the responses to this question were somewhat mixed, with 24 respondents not answering the questions. Of those who did, a large proportion of the total (73%) agreed that the investor focus was appropriate while 27% disagreed.

A number of those who disagreed with the focus on investors believed that MC should meet the information needs of a broad range of users. Others believed that it was essential that management take a broad view in deciding what should be included in MC – thereby acknowledging the importance of others an entity has relationships with. One respondent group, a consortium of corporations, global investors and other interested parties suggested an amendment to the draft standard to reflect this concern:

‘Investors’ needs are paramount when management consider what information should be contained in MC. However, information in MC will also be of interest to users other than investors, for example creditors, customers, suppliers, employees and society more widely. Management should consider the extent to which they should report on issues relevant to those other users where, because of those issues’ influence on the performance of the business and its value, they are also of significance to investors. MC should not, however, be seen as a replacement for other forms of reporting addressed to a wider stakeholder group.’

Observations from respondents who specifically made reference to the conceptual framework project varied. A few believed that the focus should be limited to current shareholders only. Others, as noted previously, concluded that a wider

range of users was more appropriate. Interestingly two respondents noted that if the conceptual framework project extended the primary users of financial reports to include creditors as was being suggested, and is the view taken in the conceptual framework project, then their view was that the focus solely on investors for MC was still appropriate.

In conclusion, as far as MC is concerned, the view we took in the MC discussion paper is that that the focus should be on investors as the primary users. We are still analysing the detail of the comment letters received, but many respondents supported the view we expressed in our discussion paper. Furthermore, we also believe that the primary focus on MC should be the same as for the financial statements that MC supplements and complements.

Can the same qualitative characteristics be applied to all components of financial reports?

The current IASB framework refers to financial statements, consisting of primary statements and notes. As noted earlier in this letter, in considering a broader information set in developing the MC discussion paper, the only new component we envisaged was MC. However, even just adding this one new component resulted in issues when we set about determining the relevant qualitative characteristics. Our starting point was the existing IASB framework. Initially our proposal was to use the same terms for the qualitative characteristics for MC as are in the existing framework. This met with concern from the IASB, specifically the Board asked us to consider whether it was appropriate to relate qualitative characteristics from the Framework to MC. As a result, our final view was:

*‘We believe that *understandability* and *relevance* should be applicable in the preparation of MC and accordingly should be reflected in the qualitative characteristics. Rather than using the *Framework* terms *reliability* and *comparability* we use *supportability*, *balance* and *comparability over time*.’ (para 61)*

The majority of respondents, 86% of whom answered the question, agree with the principles and qualitative characteristics identified by our team; while, 14% of those who responded disagreed. The question was not answered by 18 respondents. Of those who disagreed, a number believed that the same terminology should be used for both MC and the Framework.

In our view, this reinforces the need to define upfront what constitutes financial reporting. In addition, based on our experience, we believe that the conceptual framework team should also consider whether or not there will need to be more than one set of qualitative characteristics applying to the various components of financial reporting.

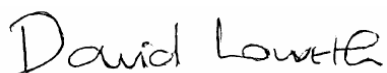
Should placement criteria be developed?

At the request of the IASB, we developed and presented some placement criteria to assist the IASB in determining whether information should be disclosed in MC or the financial statements. The clear objective of adding this section to our discussion paper was to gain some early feedback for the conceptual framework project team.

Only 81 of the 116 respondents answered this question. Three-quarters of those who answered the question thought the placement criteria suggested by the project team were helpful and, if applied, are likely to lead to more consistent and appropriate placement of information within financial reports. A significant number of those who did not agree with the proposal did so because they believed that placement criteria should not be part of the MC model, but should be considered within the conceptual framework project.

In conclusion, the development of placement criteria as part of the conceptual framework project would be welcomed by respondents. In addition, a number of respondents would like the development of such criteria to include field testing.

Yours sincerely



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APPENDIX A: COMMENTS ON FINANCIAL REPORTING

A user community perspective:

‘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 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.’ (CL9 – Standard Life Investments)

A preparer’s perspective:

‘We agree that management commentary is an integral part of the financial reporting package. Such discussion provides investors with important information to bridge the gap between the financial accounting requirements and economic events. As a result, investors are afforded better insight necessary to interpret and assess the related financial statements, the environment that the company operates in as well as the issues impacting management and how management views these issues. Without a management commentary, investors would lack key decision making information.’ (CL49 – UBS AG)

The relevance to the framework:

‘Indeed, the MC is so important, and the links between it and the financial statements so great, that we believe the IASB’s Framework document should be extended to cover the MC. We note in this context that the Framework is currently under examination for improvement. Since this project is still at a fairly early stage it appears to be a great opportunity to discuss a possible extension of the scope of the Framework to other financial reporting, and thereby bringing it more into line with the wording of the IASCF Constitution and the IFRS Preface.’ (CL105 – European Financial Reporting Advisory Group)

Audit consequences:

‘The G100 does not consider the MC should form part of the financial report. The G100 considers that the MC is an essential part of communication with shareholders as part of the annual report. We consider that the MC is a component of financial reporting but would distinguish it from the financial report, which in our view, comprise the financial statements and notes thereto which are all subject to audit. We do not believe that MC should be

included in the scope of the audit opinion on the financial statements.’ (CL20 – The Group of 100)

‘If Management Commentary would be an integral part of the financial statements important consequences for the audit would arise, because the audit of Management Commentary is different from the one on financial statements. In fact, the information contained in Management Commentary is more qualitative and subjective in nature, with elements that are not objectively verifiable.’ (CL45 – The Italian accountancy profession)

APPENDIX B: REFERENCES MADE TO THE CONCEPTUAL FRAMEWORK PROJECT IN THE ANALYSED COMMENT LETTERS

PURPOSE OF MC – Questions 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?

“IBF believes that focussing on investors is appropriate and on the same primary users as defined in the IASB’s ‘Framework’. We note in this context that the IASB has tentatively decided to revise what its Framework states on primary users of financial statements. Whereas currently the Framework identifies investors as primary users, the IASB has tentatively decided to extend this to include creditors. In circumstances where MC appears to us to be a document prepared mainly with capital markets in mind, we consider that even if IASB implements its tentative decision, the focus of MC should remain on investors” (CL23 - Irish Bankers Federation).

“The focus must be on the needs of the investors as the MC is part of the reporting package and the current draft IASB/FASB *Conceptual Framework* identifies investors as the primary user group for financial statements. As the Discussion Paper states in paragraph 25, the IASB *Framework* refers to seven classes of users, but as this is in the context of general-purpose statements, it is not relevant. We concur with the arguments in paragraph 30, that the MC should not be regarded as a vehicle for meeting the needs of other classes of users. This does not mean that other users will not find the report informative” (CL76 – Certified General Accountants Association of Canada).

“While we agree with the three elements suggested by the project team, we do not agree with the focus on the needs of investors. While we recognise that the use of the term investors is consistent with the IASB’s *Framework*, it suggests that directors may potentially have a duty of care that extends beyond the members of their company to all investors, and perhaps to prospective investors. Given the risks and uncertainties associated particularly with forward-looking statements, this reinforces our view that any MC guidance issued by the IASB should not be mandatory at this point in time. Alternatively, bearing in mind the forward-looking orientation of MC, the objective might be characterised as being to provide information to members rather than investors as a whole” (CL77 – UK 100 Group).

“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 the needs of a wider range of users similar to the range of users of financial statements as envisaged under the IASB Framework” (CL86 – Hong Kong Institute of Certified Public Accountants).

“We broadly agree with the objectives set out in paragraph 34 and that the guidance we support the IASB developing should focus on the needs of investors.

However we prefer the focus to be described as directed at the interests of the existing shareholders, since they are the owners of the business and the prime beneficiaries of the MC. We also believe that consideration should be given to adopting this approach as part of the current review of the IASB Conceptual Framework” (CL87 - CBI).

“HoTARAC notes that the IASB conceptual framework is currently under review. It may be that the appropriate “information needs focus” of MC may be influenced by the outcome of the review”(CL 102 - HoTARAC).

“Rather than just focusing on the needs of investors, we suggest the needs of the other 6 category of users as explained in the IASB’s Framework should be taken into consideration” (CL 103 – Malaysian ASB).

“We believe in principle that the focus should be on the needs of the same primary users as defined in the IASB ‘Framework’, which is currently being re-examined in the conceptual framework project. On the basis of the current Framework, we agree that the main focus on the needs of investors is appropriate. However, also other stakeholders have an interest in the information provided in the MC according to our experiences in Denmark” (CL104 – Foreningen af Statsautoriserede Denmark).

“The Committee believes that the definition of potential users within the IASB framework is relevant for MC and should be relied on for MC guidance. The framework lists seven different groups of users and states, that information should be useful “to a wide range of users making economic decisions” (paragraphs 9 and 12).

Regarding the potential users and qualitative characteristics of MC the committee recognises that the IASB framework will be subject to major changes in the medium term, since the Financial Accounting Standards Board (FASB) and the IASB are working on a joint project that will produce a future common conceptual framework for both standard-setters” (CL105 – Basel Committee of Banking Supervision).

“The FRSB agrees with the three elements for the objective of MC as proposed in paragraph 34 of the Discussion Paper. However, the FRSB considers that MC should meet the information requirements of users rather than investors. The FRSB acknowledges that the focus of information requirements of investors is consistent with the focus of financial statements as identified in the *Framework for the Preparation and Presentation of Financial Statements* (the *Framework*). However, the FRSB considers that the focus on investors alone may limit the applicability of a Standard on MC to profit-oriented entities only. This has unnecessary and undesirable consequences for jurisdictions like New Zealand where entities in all sectors are required to prepare their financial statements in compliance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS). In

addition, we note that based on the Board’s deliberations to date on the objectives of financial reporting in its conceptual framework project, it has been acknowledged that a focus on investors seems too narrow” (CL107 – Institute of Chartered Accountants in New Zealand).

“We think that the focus on investors is appropriate. We note in this context that the IASB has tentatively decided to revise what its Framework says about the primary users of financial statements; at the moment the Framework states that investors are the primary users, but the IASB has tentatively decided to extend this to include creditors. As we see the MC as a document prepared primarily for the capital markets, our view is that, even if the IASB implements its tentative decision, the focus of MC should remain on investors. It might be useful to include in the definition of MC a reference to this focus on investor information needs” (CL115 - EFRAG).

PRINCIPLES, QUALITATIVE CHARACTERISTICS AND CONTENT OF MC – Question 5: Do you agree with the principles and qualitative characteristics that the 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?

“We think that the principles of MC are appropriate. In our opinion, it is not necessary to establish new qualitative characteristics for management commentary. The characteristics used in the framework (understandability, relevance, reliability, comparability) should also be relevant for the MC. It is important to have clear understandable characteristics for all parts of the financial report” (CL4 – Munich Re Group).

“CPA Australia believes that the principles and qualitative characteristics should be based on the Framework to ensure a consistent approach in meeting the needs of users. We have a strong preference for consistent use of terms, so that users and preparers are not confused” (CL13 – CPA of Australia).

“We can’t fully agree with the project team’s conclusions concerning the qualitative characteristics. Understandability and relevance are defined in accordance with the Framework – referring to this we do not raise any objections. But we disapprove of using the terms “supportability” and “balance” rather than the Framework term “reliability”. This will cause terminological confusion, but will not give rise to advantages in form and content of MC. Nevertheless, we accept that the different nature of information provided by MC will result in a different perception of reliability. As mentioned before, we also disapprove of limiting the scope of comparability to comparability over time” (CL22 – Institut für Rechnungslegung).

“We broadly agree with the characteristics developed. However, we are not convinced of the need to invent new characteristics (such as supportability and

balance) instead of using the existing Framework terms. The characteristics should also mention the balance between forward-looking information and past information. (CL27 – Federation des Experts Comptables Européens)

The qualitative characteristics of management commentary include supportability and balance, instead of reliability which is included as a qualitative characteristic of financial reporting in the Framework. We suggest that the qualitative characteristics be kept consistent between financial reporting and management commentary and that any amendments to these qualitative characteristics in the Framework be incorporated in the management commentary framework ” (CL37 – South African Institute of Chartered Accountants).

“Framework states “qualitative characteristics are the attributes that make the information provided in financial statements useful.” As such, the project team needs to justify why some of the qualitative characteristics are not included in MC rather than inquiring what qualitative characteristics of the framework need to be included in the MC. In our opinion, MC should include all the qualitative characteristics, if the project team does not have clear justification why some of the qualitative characteristics in the framework must not be included in MC. By the same token, it needs to be justified why qualitative characteristics such as materiality, faithful representation, prudence, and completeness cannot be the qualitative characteristics for the MC. Especially, justification is needed about MC avoiding boiler-plate approach but not adopting materiality. Justification is also needed for not requiring faithful representation as a qualitative characteristic while the project team selects supportability as a new qualitative characteristic” (CL42 – IFR Standards - Korea).

“Regarding the qualitative characteristics, we believe that it is essential to keep the discussion in line with the ongoing work on the Conceptual Framework. Any requirement or guidance dealing with MC should not include modifications of the qualitative characteristics before a more general discussion has taken place between the IASB and its constituency. We attach particular importance to the concept of reliability, which is a key aspect of our supervisory approach when it comes to financial information and should therefore remain, in our opinion, a defining qualitative characteristic of the Framework. We noted that, in the current Framework, the concept of reliability includes both balance and supportability as defined in the discussion paper. Balance reflects the idea of “free from bias”, referred to as “neutrality” in the definition of reliability in the Framework. In the same way, supportability refers to “faithful representation” in the Framework” (CL53 - CEBS).

“We broadly agree with the principles and qualitative characteristics as presented in paragraphs 39 and 40 of the discussion paper, especially regarding the supportability criterion, since we believe these qualitative characteristics are consistent with the Framework” (CL72 - Mazars).

“Paragraphs 58–72 provide useful discussions on qualitative characteristics and reflect the substantial work that has been conducted by the project team. Some new terms such as *sustainability* and *balance* are introduced and it is possible that these conceptual terms may be misunderstood and that translation into other languages will produce problems. We would recommend that the project team examine the Qualitative Characteristics in the draft IASB/FASB *Conceptual Framework* and discuss their application to the MC. In our opinion, these Characteristics are desirable for both financial and non-financial information and it reduces the confusion that might arise by introducing new characteristics for one particular document” (CL76 – Certified General accountants of Canada).

“We also agree with the qualitative characteristics proposed in the preparation of the MC on the basis that these are generally consistent with the framework for the preparation and presentation of financial statements. However, we would prefer to use the same framework terminology of reliability and comparability, instead of supportability, balance and comparability over time terms used in the proposal. This will avoid confusion and ensure consistency of the MC with the IASB framework” (CL85 - Telstra)

“We note that some of the terms used in section 3 such as “Supportability” and “Balance” differ from the terms “Faithful representation” and “Neutrality” used in the discussion on reliability in the framework. It was uncertain if the meaning was meant to be changed or whether the Discussion Paper is anticipating a change of wording in the framework” (CL92 – BDO Global).

“With regard to the qualitative characteristics, we broadly agree with the proposals of the project team, and which are consistent in the main with the IFRS framework.

We would prefer that new terms are not introduced as far as possible, and we query here the need for the term ‘supportability’ (paragraphs 75 – 77) rather than ‘reliability’. An alternative would of course be to update the framework in due course.

With reference to comparability, we would point out that this should be interpreted as comparability over time rather than comparability to other companies. We believe that comparability to other companies is too subjective for the information to be presented to be reliable.

We qualify our answer somewhat however, by noting that the Discussion Paper uses phrases that may become obsolete as a result of the project to align the IASB’s conceptual framework with that of the United States” (CL93 - LSCA).

“The Committee supports maintaining consistency with the IASB framework when defining the characteristics of MC. This recommendation would necessitate reinstating the concepts of “supportability” and “balance” under the term

“reliability”. The committee also suggests using the characteristic of “comparability” instead of “comparability over time”. The committee also questions whether there is a need to create a distinct set of qualitative characteristics for MC. The committee believes that the definitions within the IASB framework are well founded and that MC will be a part of the overall IFRS-environment. Therefore the Committee believes that the qualitative characteristics within the IASB framework are relevant for MC and recommends that they be relied upon for MC guidance” (CL105 – Basle Committee on Banking Supervision).

“In general, the FRSB agrees with the principles and qualitative characteristics identified in the Discussion Paper. However, it notes that, notwithstanding that the Discussion Paper considers that MC is focused on and aimed at the same users as financial statements (investors), the qualitative characteristics for MC are not completely matched to those for financial statements, namely understandability, relevance, reliability and comparability, as set out in the *Framework*. For instance, the proposed qualitative characteristics of “supportability”, “balance” and “comparability over time” are subsets of the broader characteristics of “reliability”, “neutrality” and “comparability”. While a pronouncement on MC may emphasise these subsets as being especially important for MC, the FRSB considers that it is more useful and consistent in principle if the same general qualitative characteristics as the *Framework* were used. In addition, any discussion on the qualitative characteristics of MC will need to be revised, to take account of the Board’s deliberations and decisions arising from its conceptual framework project” (CL107 – FRSB of the Institute of Chartered Accountants of New Zealand).

PLACEMENT CRITERIA – Question 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?

“Yes, the placement criteria are helpful. It is important, however, that the criteria are fully assessed and tested by the project team on the conceptual framework” (CL3 - ASB), (CL23 – Irish Bankers Federation).

“The discussion of placement criteria in section 5 of the discussion paper represents a useful preliminary assessment of the underlying issues. However, we are not convinced that the criteria proposed on page 53 are sufficiently clear and robust. This topic should be addressed and tested comprehensively as part of the conceptual framework project” (CL17 - ICAEW).

“We believe it would be premature to discuss placement criteria at this point. This discussion should be delayed to phase E of the IASB-FASB Framework project” (CL19 – German Accounting Standards Committee).

“Given the existing IASB – FASB framework project we believe it is too early to discuss placement criteria at this point” (CL32 – Austrian Financial Reporting and Auditing Committee).

“The discussion of placement criteria is helpful. However, the criteria need to be fully assessed and tested by the project team on the conceptual framework. In Canada, there are required regulatory reports in addition to financial statements and MD&As that provide useful information to investors. The project team on the conceptual framework may want to consider placement issues related to relevant disclosures currently contained in Canadian reports such as information circulars and annual information forms” (CL33 – CPR Board of the Canadian Institute of Chartered Accountants).

“The Treasury considers this would be a useful element of the IASB Framework project” (CL43 – New Zealand Treasury).

“We do not believe that the suggested placement criteria would be helpful. As described in paragraph 155, there is a risk that the views of this project on placement criteria might not align with the views that emerge from the joint Conceptual Framework project between the IASB and the FASB. The placement criteria should be addressed pending development of the Conceptual framework project. Once the scope of notes to financial statements is determined, disclosure items which have different nature from those would automatically fall within MC” (CL57 – ASB of Japan).

“The placement criteria suggested by the project team are helpful, although we believe they should be thoroughly field tested before being introduced. We also believe that it will be important for the IASB to complete the review of its *Framework* before finalising these criteria” (CL77 – UK 100 Group).

“We suggest that the project team reviewing the Conceptual Framework considers the proposals as we believe that in the longer term it would be helpful to see the placement criteria within the Framework itself” (CL89 - PwC).

“Generally we agree with the placement principles as described in par. 169 (a. and b.). However, we think that this discussion should be postponed to a later point in time as part of the Framework project” (CL90 – Federation of German Industries).

“While we can see the benefit of clear placement criteria, we do not believe that placement criteria should be included as part of the MC model until further work has been done on this topic and the review of the framework is complete” (CL100 – British American Tobacco).